OFFICIAL TRANSCRIPT OF PROCEEDINGS BEFORE THE POSTAL RATE COMMISSION

In the Matter of:

RATE AND SERVICE CHANGES TO IMPLEMENT FUNCTIONALITY EQUIVALENT NEGOTIATED SERVICE AGREEMENT WITH HSBC NORTH AMERICA HOLDINGS, INC.

Docket No. MC2005-2

VOLUME #2
MATERIALS INCORPORATED INTO THE RECORD PURSUANT TO P.O. RULING NO. 2

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ORIGINAL

HSBC North American Holdings Inc.

John H. Harvey
(HSBC-T-1)

ANSWER OF HSBC WITNESS HARVEY
TO INTERROGATORY APWU/HSBC-T1-1

APWU/HSBC-T1-1. Is it correct to assume from your response to OCA/HSBC-T1-2(c) that the forecast of HSBC's before rates first class volume and the forecast of HSBC's before rates standard volume were made using the assumption that postage rates would be the same level as they are currently? If this is not a correct assumption please provide the specific assumptions made about postage rates when making those forecasts.

ANSWER:

Yes.

ANSWER OF HSBC WITNESS HARVEY TO INTERROGATORY APWU/HSBC-T1-2

APWU/HSBC-T1-2. The before rates standard volume provided in Section III. F. of the USPS-HSBC NSA Agreement (Appendix F of the Postal Service filing) indicates that Standard mail volume is expected to decline during years 2 and 3 of the agreement.

a) Since the before rates First Class volume in your testimony is predicted to show a substantial increase during years 2 and 3 of the agreement, what factors account for the forecasted decline in Standard Mail volumes?

b) Does the increase in First Class volume combined with the decline in Standard volume indicate some conversion from Standard to First Class even without the NSA?

ANSWER:

(a) As I describe in my testimony on pages 4 and 5, the decision of whether to mail a marketing piece as First-Class Mail or Standard Mail is largely an economic decision and depends on whether the lift from First-Class Mail as compared to Standard Mail justifies the higher rate. Our specific models and decision making process are highly confidential and proprietary, and their disclosure could subject HSBC to competitive injury. I can state, however, that our projected increase in the use of First-Class Mail versus Standard Mail reflects an increase in the value of the former class versus the latter class as a marketing medium.

(b) Yes.

ANSWER OF HSBC WITNESS HARVEY
TO INTERROGATORY APWU/HSBC-T1-3

APWU/HSBC-T1-3.

a) Does HSBC currently drop ship its Standard mail?

b) In which cities does HSBC prepare its First Class mail for mailing?

c) In which cities does HSBC prepare its Standard mail for mailing?

d) As volumes convert from Standard mail to First Class mail under the "after-rates" scenario, would the First Class mail continue to be prepared and/or entered where the Standard mail is currently entered?

e) If not, describe the changes in transportation or mailing of First Class mail.

f) If First Class mail will not be transported by HSBC to the same extent as Standard mail so transported, estimate any savings to HSBC and any costs to USPS for additional processing and transportation and explain how any USPS costs are determined.

ANSWER:

(a) As suggested by the average revenue per piece figures on page 9 of USPS-T-1, Appendix A, a large portion of HSBC's Standard Mail is dropshipped.

(b) In addition to other smaller cities, HSBC prepares its First-Class Mail for entry in the following cities: Birmingham, AL; Brisbane, Los Angeles and Salinas, CA; Naperville and Peoria, IL; St. Cloud, MN; Lincoln, NE; Edison and Rockaway, NJ; Buffalo and New York, NY; Hebron, OH; and Media, PA.

(c) In addition to other smaller cities, HSBC prepares its Standard Mail for entry in the following cities: Los Angeles and Salinas, CA; Hartford and Torrington, CT; Berwyn, Bolingbrook, Downers Grove, Fox Valley, Lake Zurich, Palatine, Peoria and West Chicago, IL; Holliston, MA; St. Cloud, MN; West Caldwell and Jersey City, NJ; Orangeburg, NY; and Janesville, WI.

ANSWER OF HSBC WITNESS HARVEY
TO INTERROGATORY OCA/HSBC-T1-3

(d)-(e) Given that the First-Class rate structure does not offer destination entry discounts, HSBC is unlikely to dropship the converted First-Class Mail. On the other hand, as noted in my response to subpart (a) of this interrogatory, a large portion of HSBC's Standard Mail is currently dropshipped. I am not aware of any other significant changes that would occur as mail converts from Standard Mail to First-Class Mail..

(f) I am not an expert on postal costs or private-sector transportation costs. Nonetheless, it is my understanding that converting letters from Standard Mail to First-Class Mail is likely to reduce the private-sector cost that HSBC pays to have its mail transported, since the Postal Service will be providing more of the transportation.

ANSWER OF HSBC WITNESS HARVEY
TO INTERROGATORY OCA/HSBC-T1-1

OCA/HSBC-T1-1. Your testimony on page 7, beginning at line 9, makes reference to the factors driving volume forecasts.

(a) Please provide the methodology used to derive the "Before Rates" forecast. Please state all assumptions, exogenous data, and the modeling procedures, providing sufficient information for an analyst to evaluate the forecasts.

(b) Please provide the methodology used to derive the "After Rates" forecast. Please state all assumptions, exogenous data, and the modeling procedures, providing sufficient information for an analyst to evaluate the forecasts.

(c) One basis for differences between the two forecasts would be a change in the cost of mailing a piece resulting from the implementation of the NSA. Is this the only factor impacting the differences between the two forecasts, or are their other factors? Please explain all differences underlying the "Before Rates" and "After Rates" forecast assumptions.

ANSWER:

(a) Managers from each HSBC unit that was expected to generate First-Class Mail eligible for the NSA discounts were surveyed about the volume of First-Class Mail that the unit actually entered during 2000-03 and was projected to enter without the NSA during 2004 through 2007. The managers were asked to provide the same projections that the business units used for their own internal planning in the ordinary course of business. The precise methodologies and assumptions underlying the projections are proprietary, and disclosure would place HSBC at a competitive disadvantage. In general, however, HSBC derives mail volume projections of this kind as follows: First, for acquisition mail, the responsible HSBC analysts determine the target growth in the total portfolio in each year, and then add the projected rate of attrition of existing accounts. The sum equals the number of new accounts sought each year. Next, projections are made about (1) the share of solicitation activity by marketing

channel, including First-Class Mail, (2) the projected response rate for each marketing channel, and (3) the cost effectiveness of each channel. Grossing up the desired growth in accounts by the projected response rate of each marketing channel, including First-Class Mail, and taking cost effectiveness into account, HSBC develops the projected volume of solicitations via each marketing channel. Portfolio mail follows a similar process except the targets are for convenience checks, balance consolidations, etc., and there is no attrition adjustment.

(b) Managers from each HSBC unit that was expected to generate First-Class Mail eligible for the NSA discounts were surveyed about the extent to which the proposed discounts would increase the projected "Before Rates" volume of First-Class Mail from the unit during each relevant period. The precise methodologies and assumptions underlying the responses rely on projected values for responses rates, "lift" (incremental response rates resulting from the use of First-Class Mail rather than Standard Mail), and lifetime account values that are highly proprietary, and cannot be disclosed without placing HSBC at a competitive disadvantage. A similar analysis based on publicly available data, however, was submitted by Bank One witness Lawrence G. Buc in Bank One NSA case (Docket No. MC2004-3).

(c) The After Rates forecasts were based on the assumption that HSBC would receive the rate discounts offered by the NSA; the Before Rates forecasts were based on the assumption of no NSA, and hence no NSA discounts. All other assumptions were held constant in the two scenarios.

ANSWER OF HSBC WITNESS HARVEY
TO INTERROGATORY OCA/HSBC-T1-2

OCA/HSBC-T1-2. Please turn to your testimony, page 4, lines 9 and 10, where you indicate that the attractiveness of alternative channels is likely to increase if the next postal rate case results in a substantial increase in postal rates.

(a) Please explain your concept of "substantial" and how this is related to elasticity of demand for First Class Mail. Please quantify your response.

(b) Is it essentially your testimony that the proposed NSA will result in no increase in volume in the event of a substantial increase in postal rates, the effects of the NSA being offset by the increased rates? Please explain.

(c) It is expected that the Postal Service will file a general rate case in the near future. How would a six percent increase in the cost of mail affect your projections in Tables 2 through 4? Please quantify your answer.

(d) If a second rate increase was subsequently to occur in the following year, how would the second increase in rates impact your projections? Please quantify your answer.

ANSWER:

(a) Alternative marketing channels are potential substitutes for First-Class Mail. An increase in the cost of First-Class Mail compared with alternative marketing channels, *all other things being equal, will tend to cause the amount of* First-Class Mail service demanded by HSBC to decrease, and the usage of alternative marketing channels by HSBC to increase. In economic terms, the cross-elasticity of demand for alternative marketing channels with respect to the price of First-Class Mail is positive. "Substantial," in this context, is meant as synonymous with "large" or "significant," and is a relative concept. *The greater the increase in the cost of First-Class Mail vis-à-vis* alternative marketing channels, the greater the substitution that is likely to occur.

(b) My testimony does not offer an answer to your question, which is beyond the scope of this case. The proposed NSA discounts, all other things being held

constant, will decrease the net cost of First-Class Mail to HSBC, thereby encouraging HSBC to enter more First-Class Mail. A general increase in First-Class rates, all other things being equal, will tend to cause HSBC to reduce its use of First-Class Mail. If both the NSA and a general rate increase occur, the effects may tend to offset. We have not tried to quantify the relative significance of the two effects, however, since the relevant question before the Commission in *this* case is the volume effect of the NSA alone—i.e., the rate and classification proposal that the Commission is being asked to evaluate in this case.

(c) A six percent increase in the cost of postage would tend to decrease both Before Rates and After Rates volume by roughly the same amount, leaving the increment in First-Class Mail volume generated by the NSA roughly as projected in my testimony. The precise amount is dependant on a host of factors that enter our proprietary models. I have not been able to calculate a more precise answer to this question, however.

(d) A second increase in the cost of postage would tend to decrease both Before Rates and After Rates volume by roughly the same amount, leaving the increment in First-Class Mail volume generated by the NSA roughly as projected in my testimony. The precise amount is dependant on a host of factors that enter our proprietary models. I have not been able to calculate a more precise answer to this question, however.

ANSWER OF HSBC WITNESS HARVEY
TO INTERROGATORY OCA/HSBC-T1-3

OCA/HSBC-T1-3. Please turn to your testimony, page 4, lines 14 through 20, where you discuss the use of both First-Class and Standard Mail for solicitations. You subsequently indicate that the volume increase in First-Class Mail is due entirely to the conversion of Standard Mail to First-Class Mail. In Tables 1 through 4 on pages 6 and 7 of your testimony you provide historical and projected First-Class Mail volumes.

(a) Please provide the Table 1 data for the years 1995 through 2001; if data are not available for a specific year, please indicate the reason for data unavailability.

(b) Please also provide Standard Mail volumes for the years 1995 through 2004 as well as Standard Mail projections for the forecasted three years. In the case of the forecasted years, projections should be on the basis of "with NSA" and "without NSA."

ANSWER:

(a) We do not have the requested information for the years 1995-1999, and many weeks of investigation and research among individual business units would be needed to determine whether the data exist elsewhere in HSBC. In all likelihood, the data would be grossly incomplete, because many of the relevant volume data (if they were ever compiled at all) were in the possession of third-party vendors whose contracts with HSBC have ended, or HSBC employees who are no longer employed by the company.

In the year 2000, HSBC entered 355,025,142 pieces of First-Class operational and solicitation mail. In the year 2001, the corresponding volume was 425,855,264 pieces. Although, the available HSBC records do not allow a precise disaggregation of these volumes between operational and solicitation mail, I do know that more than 70 percent of the mail in each year was operational.

(b) We do not have the requested information for the years 1995-1999, and many weeks of investigation and research among individual business units would be

ANSWER OF HSBC WITNESS HARVEY
TO INTERROGATORY OCA/HSBC-T1-2

needed to determine whether the data exist elsewhere in HSBC. In all likelihood, the data would be grossly incomplete, because many of the relevant volume data (if they were ever compiled at all) were in the possession of third-party vendors whose contracts with HSBC have ended, or HSBC employees who are no longer employed by the company.

HSBC's Standard Mail volumes for 2000-2004 (historical) and 2005-2007 (projected Before Rates volume) are as follows:

Year	Std. Mail Volume
2000	52,957,483
2001	123,517,038
2002	222,549,993
2003	287,404,493
2004	336,299,264
2005	604,623,661
2006	596,187,001
2007	586,420,084

"After Rates" Standard volumes for 2005-2007 are 16 million pieces less for 2005 and 20 million pieces less for 2006 and 2007, because our "After Rates" volume for First-Class mail is predicated on a switch from Standard Mail.

ANSWER OF HSBC WITNESS HARVEY
TO INTERROGATORY OCA/HSBC-T1-4

OCA/HSBC-T1-4. Please turn to your testimony, page 4, lines 14 through 20. For Tables 1 through 4 in your testimony please indicate how much of the historical and projected solicitation mail is "to encourage existing customers to use their credit cards more often and to use other products and services," and how much mail is for the acquisition of new accounts.

ANSWER:

The mix of HSBC solicitations between portfolio and acquisition solicitations is highly proprietary information. Disclosing it would place HSBC at a competitive disadvantage; we do not believe that the financial institutions in the previous NSA cases (Capital One, Discover, and Bank One) were required to disclose this information.

ANSWER OF HSBC WITNESS HARVEY
TO INTERROGATORY OCA/HSBC-T1-5

OCA/HSBC-T1-5. *Please turn to page 9 of your testimony, lines 5 through 9.* Please provide a quantitative methodology for projecting the tipping point, the potential level of mail at the tipping point, and any additional information developed subsequent to the filing of your testimony.

ANSWER:

Answering this question would require disclosure of internal HSBC data on the response rates of its mailings, the "lift" experienced between Standard and First-Class mailings of the same solicitations, and the expected lifetime present value of accounts thereby generated. This information is highly proprietary, and its disclosure would place HSBC at a competitive disadvantage. We do not believe that the financial institutions in the previous NSA cases (Capital One, Discover, and Bank One) were required to disclose this information.

ANSWER OF HSBC WITNESS HARVEY
TO INTERROGATORY OCA/HSBC-T1-6

OCA/HSBC-T1-6. Please turn to page 9 of your testimony, lines 18 through 21. If possible, please explain why HSBC-North America's 4.75-percent return rate is much lower than the return rates of other financial institutions. What practices does HSBC follow to minimize its return rate?

ANSWER:

I do not know whether the HSBC return rate on solicitation mail is lower than the return rates of most other financial institutions, although I do know that our return rate on solicitation mail is lower than the rates experienced by the three other financial institutions that are parties to NSAs. I do not know the reason for the differential because I am not privy to the marketing strategies of those companies. I do know that HSBC markets to existing portfolio customers and to address lists of existing customers of our marketing partners. These address lists tend to be more accurate and current than the address lists typically available from credit bureaus, address brokers, and other third-party sources of lists.

ANSWER OF HSBC WITNESS HARVEY
TO INTERROGATORY OCA/HSBC-T1-7

OCA/HSBC-T1-7. Please refer to your testimony at pages 5-8, concerning HSBC's First-Class volume history and First-Class before rates volume forecast. Also please refer to the Postal Service's final rule on Eligibility Requirements for Standard Mail, published in the *Federal Register* October 27, 2004. What role, if any, did the final rule have on the expected increase in the before rates solicitation volume forecast during the experiment, as compared to the historic solicitation volume during the period 2002 to 2004?

ANSWER:

None. HSBC does not believe that the final rule will require any significant migration of its solicitation volume from Standard to First-Class Mail.

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

RATE AND SERVICE CHANGES TO IMPLEMENT FUNCTIONALLY EQUIVALENT NEGOTIATED SERVICE AGREEMENT WITH HSBC NORTH AMERICA HOLDINGS INC.	Docket No. MC2005-2

DIRECT TESTIMONY
OF
JOHN H. HARVEY
ON BEHALF OF
HSBC NORTH AMERICA HOLDINGS INC.

TABLE OF CONTENTS

AUTOBIOGRAPHICAL SKETCH

My name is John H. Harvey. I am Managing Director of Marketing of HSBC Card Services ("HCS"), a credit card business conducted by several subsidiaries of HSBC North America Holdings Inc., with offices at 1441 Schilling Place, Salinas, California 93901. (For convenience, I refer to the subsidiaries of HSBC North America Holdings Inc. that are operating in the United States as "HSBC-North America.") In this position, I am responsible for, among other things, managing our relationships with the AFL-CIO and its affiliates and with General Motors Corporation. I am also responsible for all aspects of marketing in connection with HCS's two largest credit card portfolios and certain other loan products, and for managing HCS's business unit that markets third party and internal non-credit products to credit card and other loan customers.

I attended Kings College in Wimbledon, United Kingdom, and the University of New Brunswick in Canada. In 1978, I joined Household International, Inc. in the Canadian operations group, where I managed various branch offices and then held several positions at the Canadian corporate office. From 1988 to 1991, I was promoted to various positions including division operations manager, director of sales for the retail services group in Canada, director of General Motors Card marketing, group director for partnership marketing, and managing director for the Union Privilege program and Enhancement Services. I assumed my current position in 2004.

I. PURPOSE OF TESTIMONY

HSBC North America Holdings Inc. and the United States Postal Service have entered into a mutually-beneficial arrangement for a Negotiated Service Agreement ("NSA"). This NSA is similar to the Capital One NSA, the Discover Financial Services ("DFS") NSA, and the Bank One Corporation ("Bank One") NSA, all previously approved by the Postal Rate Commission. Like these earlier NSAs, this NSA will reduce the Postal Service's costs of handling undeliverable mail and will encourage HSBC-North America to send more solicitations using First-Class Mail.

My testimony describes HSBC-North America and its solicitation mail and operational mail practices. I also provide HSBC-North America's forecasts of First-Class Mail volumes without the NSA ("Before Rates" volumes) and with the NSA ("After Rates" volumes) for calendar years 2005, 2006, and 2007, referred to here as Year 1, Year 2, and Year 3, respectively, of the NSA. Finally, I discuss HSBC-North America's return rates for First-Class Mail.

In discussing our marketing practices, I am unable to reveal proprietary information that might disclose competitively sensitive information about our marketing strategies to our competitors. I will discuss, to the greatest extent possible, our marketing practices as they relate to our mail operations.

II. THE HSBC GROUP

Headquartered in London, HSBC Holdings plc ("HSBC Holdings" and together with its subsidiaries, "HSBC Group") is one of the largest banking and financial holding companies in the world. HSBC Holdings' subsidiaries and affiliates have

over 10,000 offices and over 220,000 employees in 76 countries and territories in Europe, the Asia-Pacific region, the Americas, the Middle East and Africa.

HSBC Holdings' banks have won numerous awards, including Best Consumer Bank in Global Finance's World's Best Banks in 2004, and World's Best Bank in the 2004 Euromoney Awards for Excellence. A partial listing of HSBC Group's awards and rankings is attached as Appendix A. HSBC Group also believes that it can make a real difference in people's lives by supporting educational, environmental, and community projects. In 2003, HSBC Group's charitable contributions exceeded $47 million worldwide (including over $20 million of donations in North America). Thousands of HSBC-North America employees also donated their time and experience to projects such as Junior Achievement, Project JumpStart, the United Negro College Fund, and the Hispanic Scholarship Fund.

HSBC Group developed its presence in the United States in recent years by acquiring Marine Midland Banks, Inc., and Household International, Inc. HSBC North America Holdings Inc. comprises all of the businesses of HSBC Group in the United States and Canada, including the businesses formerly owned by Household International, Inc. Through an international network linked by advanced technology, including a rapidly growing e-commerce capability, HSBC-North America now provides a comprehensive range of financial services in the United States to over 60 million customers. These services include personal financial services; commercial banking; corporate, investment banking and markets; private banking; and other financial activities. As a lender and credit card issuer, HSBC Card Services is a direct competitor of Capital One, DFS, and Bank One.

III. MAIL PROFILE OF HSBC-NORTH AMERICA

HSBC-North America sends two main types of mail: solicitation mail, which is sent by either First-Class Mail or Standard Mail, and operational mail, which is sent by First-Class Mail.

A. Solicitation Mail

Mail is one of several channels available for marketing financial services, and faces increasing competition from alternatives, such as E-mail and the Internet, event marketing, merchant marketing, telemarketing, print, television, radio, and outdoor advertising. The attractiveness of these alternative channels is likely to increase if the next postal rate case results in a substantial increase in postal rates. Nonetheless, HSBC-North America continues to view direct mail as an integral part of its marketing efforts and, as discussed below, plans to increase significantly its volume of solicitation mail in the next few years.

HSBC-North America mails solicitations to encourage existing customers to use their credit cards more often and to use other products and services. HSBC-North America also sends solicitations designed to acquire new customers. HSBC-North America uses Standard Mail for most of its solicitation mail. Although we project our use of First-Class Mail for solicitations to steadily increase in the future, even by 2007, First-Class Mail will likely account for only about one third of HSBC-North America's 886 million solicitations projected for that year.

Compared to Standard Mail, First-Class Mail is generally of greater value to HSBC-North America because of the forwarding and return service provided at no

additional charge, the certainty of in-home delivery dates, and the higher response rates from customers. In the past, however, the difference in value usually has not been large enough to justify reliance on First-Class Mail for most solicitations. To determine whether to mail a solicitation as First-Class Mail or Standard Mail, HSBC-North America tests whether the incremental response (referred to as "lift" in the industry) from sending solicitations as First-Class Mail rather than Standard Mail justifies paying the approximately ten cents differential in rates. HSBC-North America has found that the lift generally does not justify this differential. NSA discounts that reduce the cost premium for First-Class Mail would cause HSBC-North America to shift a certain amount of solicitations from Standard Mail to First-Class Mail.

B. Operational Mail

Like other financial institutions, HSBC-North America uses First-Class Mail to communicate with existing customers. These communications include, among other things, bills for credit card accounts, statements for bank accounts, letters responding to customer inquiries, and mailings of new and replacement credit cards. HSBC-North America has much less choice in the class of mail used for operational mail than for solicitation mail, and the class of mail for operational mail is generally determined by the requirements of postal regulations rather than by economics.

IV. FIRST-CLASS MAIL VOLUME HISTORY

HSBC-North America's mail volumes have grown over the last three years: Operational mail grew from 408 million pieces for the combined entities that constitute HSBC-North America in 2002 to 440 million pieces in 2004. Operational

mail in 2004 was 7.8 percent higher than in 2002. Solicitation First-Class Mail volume declined from 108 million pieces in 2002 to 89 million pieces in 2003, but then increased to 96 million pieces in 2004. Table 1 summarizes HSBC-North America's historical First-Class Mail volumes for operational mail and solicitation mail, based on Postal Service fiscal year and HSBC records.

Table 1: Historical First-Class Mail Volumes

Mail Type	2002	2003	2004
Solicitation	107,741,060	89,141,274	95,685,915
Operational	407,693,861	409,784,484	439,597,836
Total	515,434,921	498,925,758	535,283,751

V. FIRST-CLASS MAIL VOLUME FORECASTS

Tables 2, 3, and 4 compare HSBC-North America's Before and After Rates forecasts for Year 1, Year 2, and Year 3 of the Agreement:

Table 2: Year 1 Before and After Rates First-Class Mail Volume

Mail Type	Before Rates	After Rates
Solicitation	158,232,348	174,232,348
Operational	483,021,271	483,021,271
Total	641,253,619	657,253,619

Table 3: Year 2 Before and After Rates First-Class Mail Volume

Mail Type	Before Rates	After Rates
Solicitation	245,191,188	265,191,188
Operational	518,407,521	518,407,521
Total	763,598,709	783,598,709

Table 4: Year 3 Before and After Rates First-Class Mail Volume

Mail Type	Before Rates	After Rates
Solicitation	299,268,268	319,268,268
Operational	556,469,938	556,469,938
Total	855,738,206	875,738,206

A. Before Rates Volumes

As the tables above indicate, HSBC-North America intends to grow the scale of its business in the United States significantly over the next few years. To achieve this goal, HSBC-North America plans significant growth in its volume of First-Class Mail solicitations. The Before Rates forecasts are based on HSBC-North America's business plan developed by our business managers and used in the ordinary course of business for HSBC-North America's planning. Our annual budget process begins with a strategic plan that provides direction for the following year, including a new account goal forecast. Economic factors, current market conditions, and other business trends and developments are considered, as well as recent run rates and

historical performance data, testing results, and common industry trends.

Based on HSBC-North America's budget and growth plans and my business judgment, I expect Year 1 Before Rates volumes to reflect substantial growth in solicitations. In the absence of the proposed NSA, HSBC-North America would mail approximately 641 million pieces of First-Class Mail in 2005, consisting of 483 million pieces of operational mail and 158 million solicitations.

As to the Year 2 and Year 3 Before Rates volumes, I project continued growth. For Year 2, in the absence of the proposed NSA, HSBC-North America would mail approximately 764 million pieces of First-Class Mail, consisting of 518 million pieces of operational mail and 245 million solicitations. For Year 3, in the absence of the proposed NSA, HSBC-North America would mail approximately 856 million pieces of First-Class Mail, consisting of 556 million pieces of operational mail and 299 million solicitations.

B. After Rates Volumes

Based on historical volumes, discussions with senior marketing managers on the potential effect of the NSA discounts, and my business judgment, I forecast an After Rates volume increase for Year 1 of 16 million pieces. As our marketing managers have more time to adjust to the NSA's incentives, the After Rates volume increase for Year 2 would be 20 million pieces, and for Year 3 would be 20 million pieces. These volume increases would consist entirely of solicitation mail. There may also be significant organic growth in our First-Class Mail use for new solicitation campaigns as a result of the NSA incentives, but I have not relied on such "new"

First-Class Mail in developing these forecasts. Because it is difficult to quantify the volume of "new" First-Class Mail that will be sent due to the NSA discounts, my projections conservatively assume that all new First-Class Mail would be "switched" from Standard Mail.

My After Rates estimates are conservative. It is quite possible that without a cap the NSA discounts, especially in the higher volume tiers, may reach the tipping point where a very significant volume of mail would switch to First-Class Mail. HSBC-North America is continuing to conduct testing to determine more precisely the point at which the shift would likely occur.

VI. ADDRESS HYGIENE

Under the NSA, HSBC-North America will meet or exceed the postal requirements for address hygiene. HSBC-North America will perform National Change of Address ("NCOA") processing on existing operational files and on solicitation files every 90 days.

Our business records indicate that HSBC-North America's historical return rates have been as follows: for non-solicitation First-Class Mail, including statements and letters, 0.3 percent were returned; for First-Class Mail letter solicitations, approximately 4.75 percent were returned. I conservatively estimate similar return rates for 2005, 2006, and 2007. HSBC-North America's 4.75 percent return rate is much lower than the return rates of other financial institutions which have signed NSAs, as shown in Table 5, below.

Table 5: Return Rates in NSAs of Other Financial Institutions

(Percents)

	HSBC-North America	Bank One	Discover	Capital One
Operational Mail	0.3	0.3	0.3	1.2
Solicitation Letters	4.8	9	9.3	9.6
Solicitation Flats	N/A	11	N/A	N/A

Sources: Bank One: MC2004-3, USPS-T-1 Appendix A.xls; Discover: MC2004-4, USPS-T-1-AppA.xls; Capital One: MC2002-2, T3 Atta2.xls.

CONCLUSION

HSBC-North America believes that this NSA provides cost-savings to the Postal Service through electronic Address Correction Service and incentives to HSBC-North America to switch solicitations from Standard Mail to First-Class Mail, thus increasing the contribution that HSBC-North America makes to the Postal Service's institutional costs. This NSA also contains a negotiated cap on total discounts available to HSBC-North America. HSBC-North America respectfully requests that the Commission handle its NSA application with expedition under the rules for functionally equivalent NSAs and that the Commission recommend approval of this NSA, as proposed, without modification.

APPENDIX A

Awards and Rankings of HSBC, the World's Local Bank

Month	Award	Company/ Entity	Body / Publication
Nov. 2004	Best Consumer Bank	HSBC Holdings plc	Global Finance, World's Best Banks 2004
Jul 2004	World's Best Bank	HSBC Holdings plc	Euromoney Awards for Excellence 2004
June 2004	Europe's 50 Best Performing Companies, ranked 5th	HSBC Holdings plc	The European Business Week 50, Business Week
May 2004	World's 2,000 Biggest Companies, ranked 7th	HSBC Holdings plc	World's Largest Companies, Forbes
April 2004	Ranked 7th of world's leading 2,000 companies	HSBC Holdings plc	Forbes
January 2004	Ranked 41st Most Respected Company in the World	HSBC Holdings plc	FT/Price Waterhouse Coopers
January 2004	Ranked 25th Most Respected Company in the World for creating Shareholder Value	HSBC Holdings plc	FT/Price Waterhouse Coopers
November 2003	Retail Bank of the Year 2003	HSBC	Lafferty Retail Banking Awards
November 2003	Ranked 2nd best Cash Management bank globally	HSBC Holdings plc	Euromoney's Annual Cash Management Poll 2003
September 2003	Best Global Bank	HSBC Holdings plc	The World's Best Banks, The Banker Magazine
July 2003	Ranked 14th in the World, third largest in Britain	HSBC Holdings plc	The Business Week Global 1000, Business Week
July 2003	Ranked 9th in the World	HSBC Holdings plc	The Forbes Global 2000, Forbes Magazine

July 2003	Ranked 2nd by market capitalization	HSBC Holdings plc	Top 1000 world banks, The Banker
July 2003	Ranked 37th most valuable brand	HSBC Holdings plc	Interbrand's World's Most Valuable Brands, Business Week Magazine
March 2003	Ranked 50th most admired company in the World	HSBC Holdings plc	The World's Most Admired Companies, Fortune Magazine
March 2003	Ranked 2nd most admired company in the world by industry – Megabanks	HSBC Holdings plc	The World's Most Admired Companies, Fortune Magazine
January 2003	Ranked 5th for Financial Services in 2002	HSBC Holdings plc	World's Most Respected Companies, Financial Times

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON DC 20268-0001

Rate and Service Changes To Implement Functionally Equivalent Negotiated Service Agreement with HSBC North America Holdings Inc.	)))	Docket No. MC2005-2

DECLARATION OF JOHN H. HARVEY

I, John H. Harvey, hereby declare under penalty of perjury that:

(1) I am the same John H. Harvey who sponsored direct testimony on behalf of HSBC North America Holdings Inc. in this docket;

(2) The testimony, designated as HSBC-T-1, was prepared by me and under my supervision; and

(3) If I were to testify orally before the Commission on the same matters today, my testimony would be the same.

(4) If I were to respond orally today to APWU interrogatories APWU/HSBC-T1-1 through –3, OCA interrogatories OCA/HSBC-T1-1 through 7, Presiding Officer's Information Request 1 (Questions 1, 4 and 8), and Presiding Officer's Information Request 2 (Question 1, sections (a) through (d)), my responses would be the same.

John H. Harvey

April 21, 2005

RESPONSE OF HSBC JOHN H. HARVEY TO PRESIDING OFFICER INFORMATION REQUEST #1

1. (a) Does HSBC create solicitations mailing lists by employing internally generated and maintained databases, or does it rely on purchased lists with list vendors maintaining the accuracy of the addresses? If a combination of different methodologies is used, what is the percentage of each type?

(b) Please elaborate on what actions HSBC intends on taking after receiving electronic address correction information from the Postal Service, specifically including what steps will be taken to correct addresses contained within each type of solicitations mailing list discussed in (a).

RESPONSE:

1. (a) HSBC creates its solicitations mailing lists from its own databases and from information provided by its marketing partners. It also rents lists from third parties. The percentage of addresses from each source varies, and that information is highly proprietary. HSBC cannot disclose such information without placing itself at a competitive disadvantage. It will, however, provide information responsive to part (b) below to the fullest extent possible without disclosing proprietary information.

(b) For addresses from rented lists, HSBC intends to arrange with the third party list owner to have the electronic address correction information forwarded to that third party. HSBC will request the third party to incorporate that information, and it will be in the third party's best interest to do so. However, HSBC will not have the *legal* ability to force the third party to make the address changes. For addresses from HSBC's own databases and from its marketing partners, HSBC is in the planning

process to develop programs that will be used after running NCOA. The programs will enable HSBC to run all mailings against the list of addresses for which HSBC has received address correction information; if a match is found, HSBC will suppress that address.

RESPONSE OF HSBC JOHN H. HARVEY TO PRESIDING OFFICER INFORMATION REQUEST #1

4. The Negotiated Service Agreement contract defines solicitation mail that contains convenience checks endorsed "Return Service Requested" as First-Class Mail "operational mail." Request Attachment F at III.C.1. The contract also states that the one exception to the requirement that the CSR endorsement be applied to all First-Class Mail solicitations will be solicitations mail that contains convenience checks, which will continue to be endorsed "Return Service Requested" and treated by the Postal Service in accordance with that endorsement. *Id.* at II.A. Additional information on the characteristics of "conditional check mail" is necessary to assess the financial impact of this type of mail on the Negotiated Service Agreement. Is the volume of "conditional check mail" included in the solicitations mail or operational mail estimates? If the return rate of "conditional check mail" is different from the category where the volumes are accounted for, how is the return rate for "conditional check mail" factored into the financial analysis? If "conditional check mail" volumes are treated as solicitations mail, please provide for each year of the agreement: (1) the estimated volume of "conditional check mail," and (2) the estimated return rate of "conditional check mail."

RESPONSE:

4. The volumes of conditional check mail are included in the operational mail volume estimates. HSBC internally classifies conditional check mail as marketing mail, but, for this NSA, conditional check mail was classified as operational. No adjustments to the average return rates were made. However, we believe that the return rate for conditional check mail is generally higher than the return rate of operational mail and lower than the return rate of marketing mail. Thus, theoretically, the return rate of operational mail would increase when higher-than-the-category-average return rate mail is added to that category. Similarly, the return rate for marketing mail would also increase when lower-than-the-category-average return rate mail is removed from that category. Because conditional check mail was not treated as marketing mail in this NSA, the

last question of this information request is not applicable.

RESPONSE OF HSBC JOHN H. HARVEY TO PRESIDING OFFICER INFORMATION REQUEST #1

8. Please refer to HSBC-T-1 at 6-9.

(a) Has HSBC used Address Correction Service for First-Class Mail solicitations? If so, please provide the following information:

i. Identify any time period over which the service was used;
ii. Identify the date the service was last used; and
iii. If the service is no longer used, describe the reasons for discontinuing use of the service.

(b) Witness Harvey bases his return rate estimates on historical business records. Please provide this information (or a detailed summary of this information) including the time period upon which the estimate is based.

(c) Please identify any changes in the nature of HSBC's recent First-Class Mail solicitations that may have affected return rates as compared to the mail upon which witness Harvey based his estimates. Also please discuss the effect, if any, that HSBC's planned business expansion might have on the return and forwarding rates of HSBC's First-Class Mail (both solicitations and operational mail) during the term of the agreement. Please explain any adjustments incorporated into witness Harvey's estimates to account for such changes.

RESPONSE:

8. (a) In 2002, certain groups within HSBC experimented with Address Correction Service. Approximately 0.2% of HSBC's total First Class Mail volume in 2002 was sent with ACS endorsements. After this experiment, HSBC discontinued using ACS because HSBC did not find that the service was worthwhile or met its business needs.

(b) HSBC's return rate calculations were based on data from 2003. The following methodology was used to determine HSBC's return rates:

RESPONSE OF HSBC JOHN H. HARVEY TO PRESIDING OFFICER INFORMATION REQUEST #1

For marketing mail, the three HSBC units which handle marketing mail were surveyed and asked to provide their UAA volumes for 2003. The data were then aggregated to reach an overall return rate for solicitations. Similarly, for operational mail, the six HSBC units which handle operational mail were surveyed and asked to provide their UAA volumes for 2003. These data were then aggregated to reach an overall return rate for operational mail.

(c) I am unaware of any changes in the nature of HSBC's recent First-Class Mail solicitations that may affect its return rates. As HSBC solicitations grow in volume and reach more segments of the population, it is logical to assume that HSBC's return rates will more closely resemble the higher return rates of the Postal Service's other NSA partners. However, this possible increase in return rates was not factored into Mr. Harvey's testimony. As to forwarding rates, because First-Class Mail solicitations will be run against NCOA, HSBC does not expect significant changes in forwarding rates.

RESPONSE OF JOHN H. HARVEY TO
PRESIDING OFFICER'S INFORMATION REQUEST #2

1. Refer to USPS-T-1 at 11 (revised March 11, 2005). Witness Dauer explains that one condition necessary to trigger an upward adjustment of the discount thresholds is that HSBC's Standard Mail volume for the year in question exceeds its forecast by at least 5 percent.

   (a) Please refer to Attachment F to the Request at page 5, and confirm that the Standard Mail volume forecasts to which witness Dauer refers are 605 million for Year 1 and 596 million for Year 2. If so, identify the source of the forecasts, explain their development, and provide any independent analysis and/or calculations performed by the Postal Service to evaluate their reliability. If not, provide the correct forecasts, identifying their source, explaining their development and including any independent analysis and/or calculations performed by the Postal Service to evaluate their reliability.

   (b) Please confirm that the estimates identified in part (a) are before rates volumes, and that the after rates volumes would be 16 million lower for Year 1 and 20 million lower for Year 2.

   (c) Please confirm that the estimates identified in part (a) are for letter-shaped Standard Mail only. If not, provide the forecast volumes separately for each shape.

   (d) Refer to HSBC-T-1 at page 6, Table 1. Witness Harvey presents historical First-Class Mail volumes for 2002, 2003, and 2004. Please provide HSBC's historical Standard Mail volumes for the same years, separately for each shape.

RESPONSE:

1. (a) The Standard Mail forecasts are confirmed. HSBC business managers developed these forecasts and provided them to the Postal Service. The budget process described in my testimony arrives at forecasts that are used in the ordinary course of business for our planning decisions. Our annual budget process begins with a strategic plan and a new account goal forecast, and then

RESPONSE OF JOHN H. HARVEY TO
PRESIDING OFFICER'S INFORMATION REQUEST #2

considers factors such as current market conditions, business trends, recent run rates, historical performance data, and testing results.

(b) Confirmed.

(c) Confirmed.

(d) Standard mail volumes were 223 million pieces in 2002; 287 million pieces in 2003; and 336 million pieces in 2004, all of which were letters.

United States Postal Service

Jessica A. Dauer
(USPS-T-1)

RESPONSE OF POSTAL SERVICE WITNESS DAUER TO INTERROGATORIES OF APWU

APWU/USPS-T1-1 The address change service success rate assumed in your cost estimates is 85%. How does that compare with the Postal Service's actual experience with the Capital One NSA so far?

Response:

The 85 percent used in the HSBC analysis is assumed to be the average success rate over the three years of the agreement.

The Postal Service's actual experience in the first year of the Capital One NSA was recently reported in Docket No. MC2002-2, Data Collection Report for Sept. 01, 2003 to Sept. 30, 2004. The report states that Capital One's yearly ACS success rate was 75.96 percent. The monthly ACS success rates for the year ranged between 58.06 percent and 89.19 percent. Because the ACS capture rate has been increasing, the yearly average may be an inappropriate metric.

The trend can be seen in the Docket No. MC2002-2, Data Collection Report for Sept. 01, 2003 to Sept. 30, 2004, page 8.

Period	First-Class Marketing Marketing Volume	Physical Returns	Electronic Returns	ACS Capture Rate	3-Month Average ACS Capture Rate
September-03	54.44	1.45	2.01	58.06%	
October-03	89.92	2.77	4.70	62.94%	
November-03	89.23	2.10	5.08	70.73%	65.09%
December-03	84.32	2.43	6.50	72.77%	69.03%
January-04	57.32	0.67	3.43	83.60%	74.24%
February-04	59.70	0.40	2.87	87.64%	78.48%
March-04	55.14	1.46	4.49	75.54%	80.99%
April-04	37.66	0.397	1.60	80.12%	79.88%
May-04	56.15	0.572	2.77	82.90%	78.53%
June-04	50.40	0.426	2.64	86.09%	83.40%
July-04	62.53	0.679	2.73	80.10%	82.92%
August-04	43.99	0.425	3.51	89.19%	85.30%
September-04	102.09	0.747	3.60	82.80%	84.16%
Totals	**842.89**	**14.53**	**45.93**	**75.96%**	

**RESPONSE OF POSTAL SERVICE WITNESS DAUER
TO INTERROGATORIES OF APWU**

Please note that there can often be a lag between the month in which the solicitation is mailed and the month when Capital One receives information that about undeliverable-as-addressed pieces, either through ACS notices or the manual return of the pieces. Solicitations mailed towards the end of the month will often result in ACS notices or manual returns occurring in the following month.

The most recent controlled ACS test by the Postal Service and Capital One, which controls for the lag variance, showed an ACS success rate of 88 percent. The Postal Service believes this is the best estimate of ACS success rate at this time.

RESPONSE OF POSTAL SERVICE WITNESS DAUER TO INTERROGATORIES OF APWU

APWU/USPS-T1-2 A general inflation factor of 4% is used in your calculations.

a) How does that inflation factor compare with the Postal Service's recent *experience*?

b) If actual trend inflation were to run lower than what is assumed in your model, what would be the impact on the Postal Service's savings?

c) If actual trend inflation were to run higher than what is assumed in your model, what would be the impact on the Postal Service's savings?

Response:

a.) That inflation estimate was developed last year for use in the NSA cases being filed at that time, and is, in fact, a weighted estimate (i.e., by component, such as wages, benefits, etc.) of actual inflation over the 1998-2003 time period. Therefore, the estimate does not just "compare" well with the Postal Service's recent experience, but it literally constitutes the Postal Service's recent experience for that period.

b.) If the actual trend were to run lower, then the unit costs would be less, thus increasing the contribution per piece and total contribution of the agreement.

c.) If the actual trend were to run higher, then the unit costs would be more, thus decreasing the contribution per piece and total contribution of the agreement.

RESPONSE OF POSTAL SERVICE WITNESS DAUER TO INTERROGATORIES OF APWU

APWU/USPS-T1-3 What assumptions are implicit in the revenue and cost calculations for Standard mail about drop shipping?

a) Does the profile used for Standard mail reflect HSBC's current behavior with respect to drop shipping its Standard mail?

b) If it does not, would taking that in to account have any impact on your cost and revenue analysis? If so please explain.

Response:

The Standard Mail revenue and cost calculations are derived from the company's individual billing determinants. These billing determinants include all subclasses of Standard Mail in which HSBC mails, the volume, revenue per piece, and entry unit. A weighted average is then taken for each subclass, and shown on page 9 and 10 of Appendix A of my testimony. The revenue and cost unit per piece is a weighted average of all the subclasses.

a.) Yes.

b.) Not applicable.

RESPONSE OF POSTAL SERVICE WITNESS DAUER TO INTERROGATORIES OF APWU

APWU/USPS-T1-4 In your response to OCA/USPS-T1-3 you discuss the current deployment plans for PARS.

a) What is the year-by-year deployment schedule for PARS between now and the expected full deployment in October 2007?

b) What percentage of UAA mail is expected to be handled by PARS in each year between now and the end of 2007?

c) When does the Postal Service expect to get preliminary cost information from its Phase 1 PARS plants?

Response

a.) The year-by-year deployment schedule for PARS between now and the expected full deployment in October 2007 has not been approved by the Board of Governors, and is therefore not final.

b.) The original plan was for PARS to handle, one way or another, approximately 23 percent of automatable forwardable UAA pieces in 2005, 56 percent of such pieces in 2006, and 100 percent by the end of 2007. Those plans, however, were contingent on the deployment schedule which, as noted above, is not finalized.

c.) I assume that by "cost information," you are referring to cost information focusing specifically on the PARS operation, as opposed to information from ongoing costing systems, such as IOCS, which are likely to provide information from those plants as part of the routine sampling process. Plans for special cost studies regarding PARS operations have not been finalized. Some operations data may become available in FY 2006.

RESPONSES OF POSTAL SERVICE WITNESS DAUER TO INTERROGATORIES OF THE APWU

APWU/USPS-T1-5 Could you please clarify the responses provided to APWU/USPST1-1 and APWU/USPS-T1-2? In response to APWU/USPS-T1-2, you responded to section b with the following statement, "If the actual trend [rate of inflation] were to run lower, then the unit costs would be less, thus increasing the contribution per piece and total contribution of the agreement." In response to section c you provided the following response "If the actual trend were to run higher, then the unit costs would be more, thus decreasing the contribution per piece and the total contribution of the agreement."

a) If a 3% inflation rate is entered on line (4) on the assumptions page of your worksheet "USPS T1 Appendix A revised 3-22-05" the total amount generated on the USPS value worksheet on line (7) declines by 2.2%. Can you please provide clarification as to why this happens given your response to USPS-T1-2 (b)?

b) If a 5% inflation rate is entered on line (4) on the assumptions page of your worksheet "USPS T1 Appendix A revised 3-22-05" the total amount generated on the USPS value worksheet on line (7) increases by 2.2%. Can you please provide clarification as to why this happens given your response to USPS-T1-2 (c)?

c) If the average ACS capture rate in your model were lowered from 85% to the 76% average that has been experienced under the Capital One Agreement [as reported in response to APWU-USPS-T1-1] please confirm that would lower the total USPS value of this NSA by more than 10%.

Response:

a.) Theoretically speaking, if the rate of inflation were to run lower, then unit costs would be less, thus increasing the contribution per piece and total contribution of the agreement. In the HSBC case, because all costs are connected to inflation, all costs decrease, including the ACS electronic and physical return costs, thus lowering the ACS Savings. The contribution per piece does increase, but the total contribution does not because the ACS Savings is lowered more than the contribution per piece is increased.

b.) The same is true for an increase in the inflation rate. In the HSBC case, the unit costs are higher because of the inflation rate, including the ACS electronic and physical return costs, thus increasing the ACS Savings. The contribution per piece does decrease, but the total contribution increases because the ACS Savings is increased more than the contribution is lowered.

**RESPONSES OF POSTAL SERVICE WITNESS DAUER
TO INTERROGATORIES OF THE APWU**

c.) The average ACS capture rate experience thus far under the Capital One Agreement is the average from just one year of the agreement. The 85% used in both the Capital One Agreement and the HSBC case is the average that it is expected will be achieved over the entire NSA. As stated in my response to APWU/USPS-T1-1:

> The most recent controlled ACS test by the Postal Service and Capital One, which controls for the lag variance, showed an ACS success rate of 88 percent. The Postal Service believes this is the best estimate of ACS success rate at this time.

Hypothetically, however, if the average ACS capture rate in Appendix A were to be lowered from 85% to 76%, then the total USPS value would be lowered by more than 10%.

RESPONSES OF POSTAL SERVICE WITNESS DAUER TO INTERROGATORIES OF THE APWU

APWU/USPS-T1-6 In response to APWU/USPS-T1-4 (c) you indicate that cost studies regarding PARS operations may be available in FY2006. At the USPS Board of Governor's meeting on April 12th, the expected ROI for the PARS system (phases 1 and 2) was reported. Could you please provide clarification as to the data used to generate such ROI percentages if no cost information on PARS is available?

Response:

Consistent with any type of forward-looking financial analysis, discussions regarding expected ROIs are based on projected data. Actual data on costs, volumes, etc., are not available at the time decisions must be made regarding investments necessary to implement new programs.

Response of Postal Service Witness Dauer to Interrogatories of the OCA

OCA/USPS-T1-1. Please refer to your testimony at page 13, line 3, where you state that you used an "ACS cost savings of $8.1 million."
a. Provide an electronic spreadsheet of this computation.
b. Explicitly state any assumptions made and the rationale for making them.
c. Cite or provide any inputs to the computation.
d. State whether or not you employed the Commission's method for calculating ACS cost savings. If you did not, please explain your reasons.

Response:

a.) A spreadsheet is attached.

b.) Consistent with the assumptions underlying all of my cost models, all costs reflect an annual inflation rate of 4 percent, and a contingency of 3 percent.

c.) See the attached spreadsheet.

d.) The Commission's methodology was employed, subject to the above assumptions.

Calculation of Stop-Loss Cap in Response to OCA/USPS-T1-1

	Year 1	Year 2	Year 3	Total NSA
A. Effects of ACS (Savings Estimate)				
First-Class Mail Marketing Letters:				
(1) Before Rates Avg. Cost	0.1382	0.1438	0.1495	
(2) Avg. Savings from Returns	0.0090	0.0094	0.0097	
(3) Avg. Savings (Cost) from Forwards	-	-	-	
(4) Total Avg. Savings from ACS	0.0090	0.0094	0.0097	
(5) After Rates Avg. Cost	0.1293	0.1344	0.1398	
(6) Before Rates Volume	196,842,621	298,877,229	363,314,190	
(7) Net Contribution Gain from ACS (Savings)	***1,770,784***	***2,796,228***	***3,535,049***	***8,102,061***
B. Effects of Lost Contribution (Revenue Leakage)				
(8) Before Rates First-Class Volume	679,863,892	817,284,750	919,784,128	
(9) Volume Threshold for Discounts	615,000,000	725,000,000	810,000,000	
(10) Before Rates Volume Eligible for Discounts	64,863,892	92,284,750	109,784,128	
(11) Average Discount on "Exposed" Volume	0.0273	0.0303	0.0322	
(12) Total Discounts on Before Rates Volume (Leakage)	**(1,770,784)**	**(2,796,228)**	**(3,535,049)**	**(8,102,061)**
(13) Net Increase in Contribution (before rates volume)	**0**	**0**	**0**	**0**
(14) Savings from ACS at Break-Even Volume	8,102,061 /1			
(15) Pass-through Percentage	100%			
(16) **Stop-Loss Cap Amount**	**8,102,061**			
(17) Ratio of DFS "Competitive Cap" to PRC Cap	1.1009			
(18) Cap with "Competitive Adjustment"	8,919,559			

Citations

(1) USPST1_Appendix A revised.3.22.05.xls, pg. 11, (7)
(2) USPST1_Appendix A revised.3.22.05.xls, pg. 11, (7) - (8)
(3) No forward savings are recognized
(4) (2) + (3)
(5) USPST1_Appendix A revised.3.22.05.xls, pg. 11, (8)
(6) Breakeven Volume
(7) (4) * (6)
(8) USPST1_Appendix A revised.3.22.05.xls, pg. 2 + (6)
(9) USPST1_Appendix A revised.3.22.05.xls, pg. 7
(10) (8) - (9)
(11) (7) / (10)
(12) -((8) -(9)) * (11)
(13) (7) + (12)
(14) Total NSA (7)
(15) MC2004-3 Opinion and Recommended Decision, pg. 68
(16) (14) * (15)
(17) MC2004-4 Opinion and Recommended Decision, pg. 36, 42
(18) (16) * (17)

Response of Postal Service Witness Dauer to Interrogatories of the OCA

OCA/USPS-T1-2. Please refer to Appendix B, page 1. You explain that you have used an inflationary cost growth factor, projected by the Postal Service, of 4 percent.
a. Did you make an independent determination to use a 4 percent growth factor or were you advised by others to do so? Please explain.
b. If it is your independent determination, please explain your rationale for using this growth factor.
c. If others advised you to use this factor, please state their name(s) and position(s). What was the rationale of those identified to use the 4 percent growth factor?

Response:

a- c. I did not make an independent determination of the 4 percent growth factor. Rather, I relied upon the growth factor used in the models presented by witnesses Plunkett and Ayub in Docket Nos. MC2004-3 and MC2004-4. That growth factor was accepted by the Commission in both cases, and was therefore employed in my models for this case.

Response of Postal Service Witness Dauer to Interrogatories of the OCA

OCA/USPS-T1-3. At the time witness Crum estimated the savings resulting from providing Capital One with electronic return of its solicitation First-Class Mail in lieu of physical return of this mail, was PARS deployed in any postal facilities involved in the physical or electronic return of First-Class Mail?
a. If so, please list all facilities in which PARS was deployed.
b. If not, then please confirm that witness Crum's savings estimates did not reflect the use of PARS in the physical or electronic return of First-Class Mail.
c. Is PARS currently being deployed in any postal facilities?
d. If so, then please list all facilities in which it is being deployed. Please provide the annual volume of First-Class Mail that is processed through facilities in which PARS is currently being deployed.
e. What is the target date for the full deployment of PARS?
f. Is it correct that the use of PARS to effect the physical and electronic return of First-Class Mail involves different operations than those involved in facilities where PARS has not yet been deployed?
g. If so, please provide a detailed step-by-step comparison of the operations performed on UAA mail in facilities that employ PARS versus facilities that do not employ PARS.
h. Is it reasonable to expect that the cost of returning UAA mail via facilities that utilize PARS may be different from the cost of returning UAA mail via facilities that do not utilize PARS? Please explain.
i. Please provide any quantitative information collected or developed by the Postal Service on the difference in cost between UAA mail returned via PARS versus UAA mail returned without PARS.
j. Please provide any qualitative information collected or developed by the Postal Service on the difference in cost between UAA mail returned via PARS versus UAA mail returned without PARS.

Response:

No.

a.) Not applicable.

b.) Confirmed. The cost data on which witness Crum based his analysis were from a pre-PARS environment.

c.) Phase I was deployed to 49 processing plants by the end of November 2004.

Response of Postal Service Witness Dauer to Interrogatories of the OCA

d.)

PARS Combined Schedule
9/16/2004

Serial Number	Site Name	ST	Area	Site Type
1a	Mid Florida	FL	SE	P&DC
1b	Mid Florida	FL	SE	P&DC
2	Orlando	FL	SE	P&DC
3a	Santa Clarita	CA	PA	P&DC
3b	Santa Clarita	CA	PA	P&DC
4a	Dulles	VA	CM	P&DC
4b	Dulles	VA	CM	P&DC
5	Middlesex-Essex	MA	NE	P&DC
6	North Bay	CA	PA	P&DC
7	North Metro	GA	SE	P&DC
8	Northern Virginia	VA	CM	P&DC
9	Nw Boston (Waltham)	MA	NE	P&DC
10	Charleston WV	WV	EA	P&DC
11	Flint	MI	GL	P&DC
12	Colorado Springs	CO	WE	P&DC
13	Fort Worth	TX	SW	P&DC
14	Abilene TX (Rioss) / Fort Worth (Host)	TX	SW	RIOSS
15	Pasadena	CA	PA	P&DC
16	Mojave CA (Rioss) / Pasadena (Host)	CA	PA	RIOSS
17	Baltimore	MD	CM	P&DC
18a	Cincinnati	OH	EA	P&DC
18b	Cincinnati	OH	EA	P&DC
19	Syracuse	NY	NE	P&DC
20	Watertown NY (Rioss) / Syracuse (Host)	NY	NE	RIOSS
21	Monmouth (Eatonton)	NJ	NY	P&DC
22	Minneapolis	MN	WE	P&DC
23	Oxnard	CA	PA	P&DC
24	Santa Barbara	CA	PA	P&DC
25	Queens	NY	NY	P&DC
26	Gary	IN	GL	P&DC
27	Seattle	WA	WE	P&DC
28	Industry (Alhambra)	CA	PA	P&DC
29	Charleston SC	SC	EA	P&DC
30	Youngstown	OH	EA	P&DC
31	Madison	WI	GL	P&DC
32a	Dallas	TX	SW	P&DC
32b	Dallas	TX	SW	P&DC
33	Bowling Green	KY	EA	P&DC
34	Brooklyn	NY	NY	P&DC
35	Staten Island NY (Rioss) / Brooklyn (Host)	NY	NY	RIOSS
36	Suburban MD P&DC	MD	CM	P&DC
37	North Texas (Coppell)	TX	SW	P&DC
38	Everett	WA	WE	P&DC

39a	Oakland	CA	PA	P&DC
39b	Oakland	CA	PA	P&DC
40	Portland OR	OR	WE	P&DC
41	Lexington	KY	EA	P&DC
42	Columbus	OH	EA	P&DC
43	Milwaukee	WI	GL	P&DC
44	Salt Lake City	UT	WE	P&DC
45	Provo (Rioss) / Salt Lake City (Host)	UT	WE	RIOSS
46	Anchorage	AK	WE	P&DC
47	East Texas (Tyler)	TX	SW	P&DC
48a	New York City (Morgan Station)	NY	NY	P&DC
48b	New York City (Morgan Station)	NY	NY	P&DC
49	Bronx	NY	NY	P&DC

For FY 2005, slightly less than one-quarter of UAA machinable letter volume was expected to be processed through the original PARS I sites.

e.) The target date for full deployment is October 2007, although meeting that target is contingent upon many factors, including development of technical improvements, completion of internal review processes, and approval by the Board of Governors.

f.) Yes, it is correct.

g.) PARS will intercept mail at the first machine handling, significantly reducing the mailstream processing cost of forwarding and returning mail. For presort mail, however, the ability to take advantage of savings opportunities is reduced. The first machine handling for presort mail is often not until the destination facility. The bulk of the PARS savings, however, arise when the first machine handling is at the origin facility, not the destination facility. Relative to single-piece mail, presort mail offers little potential for interception by PARS at an origin facility.

Furthermore, PARS will only intercept mail pieces that are undeliverable for move-related reason, and which match in name and address to the PARS change of address database. If sent by mailers who run their address list through NCOA, many of the

mailpieces that otherwise would be intercepted by PARS will have addresses which already would have been corrected by the NCOA process. Compared with single-piece mail, presorted First-Class Mail in general is much more likely to come from an address list that has been run against NCOA. Specifically, the Capital One NSA (MC2002-2) and all functionally equivalent NSAs (MC2004-3, MC2004-4, and MC2005-2) all have strict NCOA requirements. Therefore, NCOA will already have been run on the pieces, further reducing the impact of PARS implementation on how such mail moves through the mailstream.

As stated above, PARS will not intercept a significant portion of non-forwardable, UAA, presort, First-Class Mail before it reaches the carrier. Once such mail does reach the carrier, however, the below chart provides a step-by-step comparison of the operations *performed on UAA mail in facilities that employ PARS versus facilities that do not* employ PARS.

Non-PARS	**PARS**
At delivery unit	At delivery unit
Received by Carrier	Received by Carrier
Identify return to sender mail	Identify return to sender mail
Hand stamp reason for return	Separate by reason for return by use of special processing cards*
Separate into ACS and non-ACS	Place into trays (no longer needs to be identified as ACS and non-ACS)
Send ACS to CFS unit	Send to plant
Send non-ACS to plant	
	**In most cases no longer needs to be hand stamped*

h.) See Attachment 2, Interrogatory response APWU/USPS-7, filed February 5, 2003 in Docket No. MC2002-2 addressing the impacts of PARS on the Capital One NSA.

Response of Postal Service Witness Dauer to Interrogatories of the OCA

i.) There is no quantitative information at this time.

j.) As indicated by the different activities at PARS and non-PARS delivery units listed in response to subpart (g) of this interrogatory, it is reasonable to expect that the cost of returning UAA mail via facilities that utilize PARS may be different from the cost of returning UAA mail via facilities that do not utilize PARS.

Further, it bears repeating that reducing UAA costs would not necessarily reduce the NSA cost savings since PARS will likely affect the ACS success rate and the cost of electronic returns as well as the cost of physical returns.

In fact, two likely impacts of PARS would increase, not reduce, NSA cost savings. First, the processing of UAA mail at mechanized terminals in CFS units will be replaced with automated processing on PARS. This is expected to reduce the cost of electronic returns more than the cost of physical returns. Second, standardizing the way ACS mail is handled and eliminating the requirement to separate ACS and non-ACS mail is likely to increase the ACS success rate.

Another likely effect – changing the activities that are performed at the delivery unit for both physical and electronic returns – would have minimal effect on NSA cost savings because changing these activities would reduce the cost of electronic and physical returns by a similar absolute amount.

Response of Postal Service Witness Dauer to Interrogatories of the OCA

OCA/USPS-T1-4. What was the base year for the data used by witness Crum to develop cost estimates in the Capital One baseline case?
a. Is it possible that the base year for cost estimates in the next rate case will be different from that used by witness Crum in the Capital One baseline case? Please explain.
b. Is it possible that the period of time during which the HSBC NSA will be in effect will generally coincide with the test year of the next rate case (at least in part) and years following the test year? Please explain.

Response:

Witness Crum used BY2000 to develop cost estimates in the Capital One baseline case.

a.) I am informed that, unless the Postal Service were to seek a waiver of the Commission's rules, those rules would not permit the Postal Service to utilize the same base year as employed by witness Crum in a yet-to-be-filed omnibus rate case, whenever in the future such a case were to be filed.

b.) It is certainly possible that some part of Years 1-3 of the HSBC NSA will overlap with the test year in the next omnibus rate case, but I have no opinion whether any such overlap would properly be characterized as "generally" coinciding with the test year and years following. .

Response of Postal Service Witness Dauer to Interrogatories of the OCA

OCA/USPS-T1-5. In Appendix C of your testimony you present the HSBC NSA Proposed Data Collection Plan. Does the Postal Service plan to submit data collection reports forthe HSBC NSA that are closely modeled on the Capital One Data Collection Report that was filed with the Commission on January 31, 2005? Please explain.

Response

Yes. The data collection reports for the HSBC NSA will be closely modeled after the Capital One Data Collection Report.

RESPONSE OF POSTAL SERVICE WITNESS DAUER TO INTERROGATORIES OF THE OCA

OCA/USPS-T1-6. Please confirm that your Appendix A, page 1, line 3 incorporates an average First-Class Mail return rate of 1.23%. If you do not confirm, then please explain.

Response

Confirmed.

RESPONSE OF POSTAL SERVICE WITNESS DAUER TO INTERROGATORIES OF THE OCA

OCA/USPS-T1-7. In March 2005, at the Nashville, TN, National Postal Forum, Postal Service witness (Docket No. MC2002-2) Jim Wilson made a presentation on the National Change of Address (NCOA) service. Data from an "average" 20-million-piece mailing for which the Postal Service had utilized NCOA service and Address Change Service (ACS) were disclosed. The data showed that 5.94% of such an "average" First-Class mailing was returned, as opposed to the 1.23% figure that you use in Appendix A. Assume for purposes of this interrogatory that the 5.94% figure, rather than the 1.23% figure, is correct.

a. What is the effect on a Commission-style savings cap of a return rate that is nearly 5 times the return rate that you use? Provide all calculations and cite/provide all sources used to answer this question.

b. What is the effect of a return rate that is nearly 5 times the return rate that you use on the contribution that you have estimated? Provide all calculations and cite/provide all sources used to answer this question.

c. If the average return rate for First Class is 5.94%, then please confirm that HSBC's return rate is below the average. If you do not confirm, then please explain.

Response

I understand that you are asking me to assume (rather than confirm as fact) that the correct return rate for First-Class Mail overall is 5.94 percent, in contrast to the 1.23 percent upon which my analysis is predicated, along with the analysis in all previous NSA cases. Furthermore, I understand that posing such hypothetical questions can on occasion provide a useful means to explore otherwise cumbersome issues. I do not, however, believe that to be the case in this instance. It is my understanding, in contrast with the implication of your question, that Mr. Wilson had no intention of representing the return rate of the single mailing (by a single mailer) that he was using for illustrative purposes as average or typical of the totality of First-Class Mail. See the response of the Postal Service to OCA/USPS-1. In reality, the return rate for any single mailer is not indicative of the return rate experienced by all mailers in the same class of mail, and I have been told by Mr. Wilson that it was not presented as such by him at the Forum. His purpose, rather, was simply to point out that there is a connection between the quality of address data and return rates for mailers, which attendees could use as a

point of reference to understand the value of improving their address information. Lastly, I need to note my understanding that, even with respect to the one mailing by the one mailer discussed at the Forum, the reported return rate of 5.94 percent applied only to the portion of the mailing that was ZIP+4 coded, not the entire mailing. This distinction further underscores why the 5.94 percent figure simply cannot be assumed to apply to all First-Class Mail.

Because I believe that your entire line of questions is premised on a misinterpretation of one number presented at the Forum, I believe that accepting your assumption would foster misunderstanding of the relevant issues, rather than a better understanding. The assumption that the correct return rate for First-Class Mail overall is 5.94 percent rather than 1.23 percent appears quite implausible. As your question acknowledges, a return rate so high would suggest that the Postal Service has been underestimating the overall return rate for First-Class Mail by a factor of nearly five. My concerns are addressed more fully in response to the specific subparts of this question, and OCA/USPS-T1-8.

a.-b.) If I were to limit my response to making the adjustments in my model that relate to the single model input which you are requesting be changed in this question, the value of the NSA calculated by my model increases. This is because, with a lower than average return rate, HSBC's pieces converting from Standard Mail to First-Class would contribute more than the average piece of First-Class Mail, thereby escalating the estimated additional contribution from those converted pieces. Specifically, by changing the 1.23% on the Assumptions (page 1) of HSBC North America Holdings Inc Model, the effects would appear in Columns 13-18 on pages 5 and 6 (Ops and Mktg unit cost), on page 11 (Contrib Inputs) Line 3-10, and finally on page 12 (USPS Value) Line 4. On the other hand, because no change is made on page 8 where the ACS savings are

calculated, there would be no change in the discount cap calculations and the associated breakeven volume.

As evident from your question OCA/USPS-T1-8, this result appears contrary to your expectations. Your apparent view is that an increase in the return rate should lead to a reduction in the estimated cost of manual returns, and a decrease in the overall value of the NSA. In this question, however, you have not asked me to assume a different value for the manual return unit cost input (Page 1, Line 5).

To summarize, when the only change in my model is an increase in the overall First-Class Mail return rate, the calculated net benefit from the NSA increases. The results for any particular change in this input – whether realistic or not -- can easily be generated using my model. In my opinion, the change you are suggesting is not realistic. Please also see my answer to OCA/USPS-T1-8.

c.) I confirm that, as noted above, if one implausibly assumes that the average return rate for First-Class Mail is 5.94 percent, then HSBC's return rate of 4.75 percent for marketing mail would be lower than the assumed average.

RESPONSE OF POSTAL SERVICE WITNESS DAUER TO INTERROGATORIES OF THE OCA

OCA/USPS-T1-8. In the Spring 2003 issue of a Pitney Bowes publication, *PostInsight*, Pitney Bowes reported that the Postal Service incurs approximately $1.9 billion of UAA costs each year. Please confirm that this figure is correct or provide the correct figure. Cite/provide the source for any corrected figure.

a. If the $1.9 billion figure is approximately correct, and the return rate for First-Class Mail is 5.94%, not 1.23%, then doesn't it follow that the unit cost of physically returning mail is far lower than estimated by witness Crum, i.e., because the $1.9 billion will be spread over the much larger volume figure implied by a 5.94% return rate? If you do not confirm, then please explain.

b. If the unit cost of physically returning mail is far lower than estimated by witness Crum, then doesn't it follow that the Postal Service might be worse off in providing electronic return service in lieu of the physical return of HSBC's mail? If you do not agree, then please explain.

c. If $1.9 billion and 5.94 percent are correct figures, then doesn't it follow that the unit cost of a physical return is more like $0.12 than $0.57? If you do not confirm, please explain.

d. If 5.94 percent and $0.12 are used in your testimony at Appendix A, Page 1, is it not the case that the results in the table below will appear at Appendix A, Page 12? If you do not confirm, please explain.

HSBC North America Holdings Inc. Model
Negotiated Service Agreement
Appendix A, page 12

		Year 1	Year 2	Year 3	Total
ACS Savings					
(1)	Statement Mail	$ -	$ -	$ -	-
(2)	Marketing Mail Letter	$ (1,559,055)	$ (2,512,490)	$ (3,189,286)	**(7,260,831)**
Contribution from New Volume					
(3)	Statement Mail	$ -	$ -	$ -	-
(4)	Marketing Mail Letter	$ 1,245,336	$ 1,528,773	$ 1,499,761	**4,273,869**
(5) Total Exposure		$ 656,340	$ 964,968	$ 1,172,146	**2,793,454**
(6) Total Incremental Discounts		$ 411,268	$ 592,994	$ 628,691	**1,632,953**
(7) Total USPS Value		**$ (1,381,328)**	**$ (2,541,678)**	**$ (3,490,363)**	**(7,413,369)**

Response

It is believed that the ultimate source of the $1.9 billion estimate quoted by Pitney Bowes is the analysis contained in USPS-LR-J-69 (Docket No. R2001-1), Section C Table 5.1, Line 7. The $1.9 billion includes the costs associated with all handlings, forwarding, return, and disposal of UAA mail, across all classes of mail. It would be erroneous to

distribute the $1.9 billion to only return processing of First-Class Mail. Importantly, the return rate employed in this and all previous NSA cases also comes from USPS-LR-J-69 as well. See Tables 4.2 and 4.3.3. Therefore, the return rate and the unit cost estimates I use in my model are closely intertwined.

a.) Not confirmed. As noted in response to OCA/USPS-T1-7, I believe that using the 5.94 percent number as the average return rate for all First-Class Mail would not be credible. Moreover, as described above, the $1.9 billion figure relates to all types of UAA costs for all classes of mail, and can not appropriately be "spread over" return volumes of First-Class Mail to obtain the unit cost of returned UAA First-Class Mail.

b.) Obviously, one could always hypothetically assume a manual return unit cost so low that it would be lower than the accepted estimate of electronic return unit cost. Such an assumption, however, would not be meaningful.

c.) As noted in response to subpart a., your question is attempting to apply the 5.94 percent number and the $1.9 billion number in ways that are not appropriate.

d.) For the reasons set forth above and in my response to OCA/USPS-T1-7, the exercise you have requested would not be meaningful.

RESPONSE OF POSTAL SERVICE WITNESS DAUER TO INTERROGATORIES OF THE OCA

OCA/USPS-T1-9. Please refer to your testimony at Appendix A, Page 6.

a. Please confirm that the formula in column (13) is: = ($0.57 * 95,685,915) * (0.0475 – 0.0123) / 95,685,915. If you do not confirm, please explain.

b. Please confirm that the formula in column (13) can be written as: = - ($0.57 * 0.0123) + ($0.57 * 0.0475). If you do not confirm, please explain.

c. Please confirm that the formula in column (15) is: = ((0.85 * $0.36 + (1 – 0.85) * $0.57) * (95,685,915 * (0.0475 – 0.0123))) / 95,685,915 - 0.0123 • ($0.57 - $0.36) • 0.85. If you do not confirm, please explain.

d. Please confirm that the formula in column (15) can be written as: = - ($0.57 • 0.0123) + (0.85 * $0.36 + (1 – 0.85) * $0.57) *0.0475. If you do not confirm, please explain.

Response

a.) Confirmed, although the spreadsheet in my model does the actual calculation using inputs with more decimal places, which changes the results slightly relative to what you would obtain merely using the values you have specified.

b.) Confirmed, although the spreadsheet in my model does the actual calculation using inputs with more decimal places, which changes the results slightly relative to what you would obtain merely using the values you have specified.

c.) Confirmed, although the spreadsheet in my model does the actual calculation using inputs with more decimal places, which changes the results slightly relative to what you would obtain merely using the values you have specified.

d.) Confirmed, although the spreadsheet in my model does the actual calculation using inputs with more decimal places, which changes the results slightly relative to what you would obtain merely using the values you have specified.

RESPONSE OF POSTAL SERVICE WITNESS DAUER TO INTERROGATORIES OF VAL-PAK

VP/USPS-T1-1.

This question is a hypothetical. Please refer to your Appendix A, page 8. Assume that HSBC's marketing mail were twice as "dirty" as the rate shown on row 2 of page 8 of your Appendix A — *i.e.*, assume that HSBC's return rate were 9.5 percent instead of 4.75 percent — and confirm the following:

a. The return forecast for the volume of such "dirtier" marketing mail over the life of the negotiated service agreement ("NSA") would be as follows:

Year 1	15,032,073 returns
Year 2	23,293,163 returns
Year 3	28,430,485 returns
Total	66,755,721 returns

If you do not confirm, please provide the correct return forecast on the assumption that the return rate for HSBC's marketing mail is 9.5 percent.

b. The before rates return cost for such "dirtier" marketing mail over the life of the NSA would be as follows:

Year 1	$ 8,875,619
Year 2	$ 14,303,475
Year 3	$ 18,156,441
Total	$ 41,335,536

If you do not confirm, please provide the correct before rates return cost on the assumption that the return rate for HSBC's marketing mail is 9.5 percent.

c. The after rates return cost for such "dirtier" marketing mail over the life of the NSA would be as follows:

Year 1	$ 6,028,722
Year 2	$ 9,715,568
Year 3	$ 12,332,677
Total	$ 28,076,968

If you do not confirm, please provide the correct after rates return cost on the assumption that the return rate for HSBC's marketing mail is 9.5 percent.

d. The return cost savings over the life of the NSA would be as follows:

Year 1	$ 2,846,897
Year 2	$ 4,587,907
Year 3	$ 5,823,764
Total	$13,258,568

If you do not confirm, please provide the correct return cost savings on the assumption that the return rate for HSBC's marketing ma

Response

a-d.) Confirmed, though the use of the term "dirty" to describe to HSBC's marketing mail is an inaccurate pejorative similar to calling Standard Mail "junk" mail. And to the extent that this term is an implicit criticism of HSBC's mailing practices it is used most unfortunately in this setting. The use of this term is also inappropriate because, as required in the NSA, HSBC will be held to higher standards for address quality than obtain more generally. Moreover, return rates can

vary for a number of reasons that have nothing to do with the quality of a list. By using First-Class Mail as an advertising medium, customers like HSBC make a larger contribution to the Postal Service's institutional costs than a comparable mailer that uses Standard mail.

Also, the answers to these questions can be found by changing the 4.75 percent on the Assumption page (page 1) in USPS-T-1_Appendix.xls to 9.5 percent, and then looking on page 8 (UAA Calcs) to find the results of the change.

RESPONSE OF POSTAL SERVICE WITNESS DAUER TO INTERROGATORIES OF VAL-PAK

VP/USPS-T1-2.

This question is also a hypothetical. Please refer to your Appendix A, page 8. Assume that HSBC's marketing mail were somewhat "cleaner" than it actually is and had a return rate of 1.5 percent, which is just under one-third of HSBC's actual return rate of the 4.75 percent — as shown on row 2 of page 8 of your Appendix A — and confirm the following:

a. The return forecast for such cleaner marketing mail over the life of the NSA would be as follows:

Year 1	2,373,485 returns
Year 2	3,677,868 returns
Year 3	4,489,024 returns
Total	10,540,377 returns

If you do not confirm, please provide the correct return forecast on the assumption that the return rate for HSBC's marketing mail is 1.5 percent.

b. The before rates return cost with such cleaner marketing mail over the life of the NSA would be as follows:

Year 1	$ 1,401,414
Year 2	$ 2,258,443
Year 3	$ 2,866,807
Total	$ 6,526,664

If you do not confirm, please provide the correct before rates return cost on the assumption that the return rate for HSBC's marketing mail is 1.5 percent.

c. The after rates return cost with such cleaner marketing mail over the life of the NSA would be as follows (note: total does not add due to rounding):

Year 1	$ 951,904
Year 2	$ 1,534,037
Year 3	$ 1,947,265
Total	$ 4,433,205

If you do not confirm, please provide the correct after rates return cost on the assumption that the return rate for HSBC's marketing mail is 1.5 percent.

d. The return cost savings with such cleaner marketing mail over the life of the NSA would be as follows:

Year 1	$ 449,510
Year 2	$ 724,406
Year 3	$ 919,542
Total	$ 2,093,458

If you do not confirm, please provide the correct return cost savings on the assumption that the return rate for HSBC's marketing mail is 1.5 percent.

Response

a-d.) Confirmed. See also my response to VP/USPS-T1-1 regarding use of the pejorative

"dirty," and for how such results can be automatically derived using my worksheets.

RESPONSE OF POSTAL SERVICE WITNESS DAUER TO INTERROGATORIES OF VAL-PAK

VP/USPS-T1-3.

This question is also a hypothetical. Please refer to your Appendix A, page 8. Assume that HSBC's marketing mail somehow were "cleaner" than its operational mail — *i.e.*, the return rate for HSBC's marketing mail were only 0.25 percent instead of 4.75 percent — as shown on row 2 of page 8 of your Appendix A, and confirm the following:

a. The return forecast for such very clean marketing mail would be as follows:

Year 1	395,581 returns
Year 2	612,978 returns
Year 3	748,171 returns
Total	1,756,730 returns

If you do not confirm, please provide the correct return forecast on the assumption that the return rate for HSBC's marketing mail is only 0.25 percent.

b. The before rates return cost for such very clean marketing mail over the life of the NSA would be as follows:

Year 1	$ 233,569
Year 2	$ 376,407
Year 3	$ 477,801
Total	$1,087,777

If you do not confirm, please provide the correct before rates return cost on the assumption that the return rate for HSBC's marketing mail is only 0.25 percent.

c. The after rates return cost for such very clean marketing mail over the life of the NSA would be as follows:

Year 1	$ 158,651
Year 2	$ 255,673
Year 3	$ 324,544
Total	$ 738,868

If you do not confirm, please provide the correct after rates return cost on the assumption that the return rate for HSBC's marketing mail is only 0.25 percent.

d. The return cost savings over the life of the NSA would be as follows:

Year 1	$ 74,918
Year 2	$ 120,734
Year 3	$ 153,257
Total	$ 348,910

If you do not confirm, please provide the correct return cost savings on the assumption that the return rate for HSBC's marketing mail is only 0.25 percent.

Response

a-d.) Confirmed. As I mentioned in my response to VP/USPS-T1-1, referring to HSBC's marketing mail as "clean" or "dirty" is inappropriate.

The answers to these questions can be found by changing the 4.75 percent on the Assumption page (page 1) in USPS-T-1_Appendix.xls to .25 percent, and then looking on page 8 (UAA Calcs) to find the results of the change.

RESPONSE OF POSTAL SERVICE WITNESS DAUER TO INTERROGATORIES OF VAL-PAK

VP/USPS-T1-4.

Please refer to your testimony, page 16, lines 6-14, where you estimate the net benefit to the Postal Service over the life of the proposed NSA with HSBC.

a. Please confirm that a change in the assumed return rate of 4.75 percent for marketing mail does not affect the "increased contribution (less incremental discounts)" of $4.1 million, shown on line 9. If you do not confirm, please explain fully, and indicate the extent of the change in net contribution if the assumed return rate is 9.5 percent.

b. Please confirm that a change in the assumed return rate of 4.75 percent for marketing mail does not affect the Postal Service's "discount exposure" of ($4.4) million, shown on line 10. If you do not confirm, please explain fully, and indicate the extent of the change in discount exposure if the assumed return rate is 9.5 percent.

c. Please refer to your response to VP/USPS-T1-1, part d, and confirm that if HSBC's return rate for marketing mail were 9.5 percent, then over the life of the NSA the Postal Service would derive a net benefit of $13.0 million, computed as follows:

ACS cost savings:	$13.3 million
Increased contribution (less incremental discounts):	$ 4.1 million
Discount exposure:	($4.4) million

If you do not confirm, please provide the net benefit over the life of the NSA on the assumption that HSBC's return rate for marketing mail were 9.5 percent.

d. If you confirm preceding part c, or if you do not confirm but provide an alternate net benefit for the NSA over the life of the agreement that is somewhat greater than the $6.3 million shown on line 12 of your testimony, would you agree that, *ceteris paribus,* the dirtier the existing marketing mail the greater is the net benefit to the Postal Service under the proposed NSA? If you fail to agree, please explain fully why not.

e. Could a higher amount of return cost savings and a larger computed net benefit to the Postal Service (*e.g.*, $12.8 million instead of $6.3 million) be a basis for justifying greater discount exposure, either in the form of lower volume thresholds for existing discounts, or higher discounts at existing volume thresholds? Please explain fully any answer that is not an unqualified affirmative.

Response

a.) Not confirmed. The increased contribution is reduced to $3.0 million, because the return rate is used in calculating the Marketing Unit Cost (page 6), Column 13 and 15. Increasing the return rate to 9.5 percent would increase the Current and After Rates Return Adjustment Unit Costs by 2.7 cents and 1.8 cents respectively, thus reducing the average contribution for Before and After Rates FCM (page. 11).

b.) Confirmed.

c.) Not confirmed. See response to part a in regards to the Increased Contribution.

ACS Cost Savings	$13.3 million
Increased Contribution	$ 3.0 million
Discount exposure	$(4.4) million
Total	$11.9 million

d.) One of the effects of the NSA is that HSBC will adopt electronic ACS. Therefore it is a mathematical truism that any assumption that increases the "before-NSA UAA rate – irrespective of how unfounded or realistic it may be – would increase the calculated benefits of the NSA to the Postal Service, *ceteris paribus.*

e.) The Postal Service does not link greater or lesser ACS Cost Savings to greater or lesser exposure. The discounts are not justified by the amount of cost savings (i.e. return rate), but how a customer responds to price incentives based upon its marketing model. The Postal Service sees the largest potential value coming from the volume response of a customer, rather than a trade between ACS cost savings and discounts given. The Commission, through the use of a cap, has created a link between the two features that was not considered when we negotiated with HSBC. The Postal Service still sees them as two different benefit streams that can be combined into a single contract for administrative and litigation purposes.

RESPONSE OF POSTAL SERVICE WITNESS DAUER TO INTERROGATORIES OF VAL-PAK

VP/USPS-T1-5.

a. Please refer to your response to VP/USPS-T1-2, part d, and confirm that if HSBC's return rate for marketing mail were 1.5 percent, then over the life of the NSA the Postal Service would derive a net benefit of $1.8 million, computed as follows:

Address Change Service ("ACS") cost savings:	$ 2.1 million
Increased contribution (less incremental discounts):	$ 4.1 million
Discount exposure:	($ 4.4) million

If you do not confirm, please provide the net benefit over the life of the NSA on the assumption that HSBC's return rate for marketing mail is only 1.5 percent.

b. If you confirm preceding part a, or if you do not confirm but provide an alternate net benefit for the NSA over the life of the agreement that is somewhat less than the $6.3 million shown on line 12 of your testimony, would you agree that, *ceteris paribus*, the cleaner the existing marketing mail the smaller is the net benefit to the Postal Service under the proposed NSA? If you do not agree, please explain why not.

c. Could a lower amount of return cost savings and a resulting reduction in the net benefit to the Postal Service (*e.g.*, $1.8 million instead of $6.3 million) require a reduction in the amount of discount exposure, either in the form of higher volume thresholds for existing discounts, or lower discounts at existing volume thresholds? Please explain fully any answer that is not an unqualified affirmative.

Response

a.) Not confirmed. The increased contribution is higher because the return rate is used in calculating the Marketing Unit Cost (page 6), Column 13 and 15. Decreasing the return rate to 1.5 percent would decrease the Current and After Rates Return Adjustment Unit Costs, thus increasing the average contribution for Before and After Rates FCM (page 11).

ACS Cost Savings	$2.1 million
Increased Contribution	$4.8 million
Discount/exposure	$(4.4) million
Total	$2.5 million

b.) The alternate net benefit, as described in the hypothetical situation, does have a "somewhat less than $6.3 million" value because of the lowered return rate that was suggested. As I previously discussed, the constant use of "clean" or "dirty in these questions implies HSBC is using or is not using certain mailing practices which is unfounded.

RESPONSE OF POSTAL SERVICE WITNESS DAUER TO INTERROGATORIES OF VAL-PAK

c.) Please see my response to VP/USPS-T1-4(e).

RESPONSE OF POSTAL SERVICE WITNESS DAUER TO INTERROGATORIES OF VAL-PAK

VP/USPS-T1-6.

a. Please refer to your response to VP/USPS-T1-3, part d, and confirm that if HSBC's return rate for very clean marketing mail were only 0.25 percent, then over the life of the NSA the net benefit to the Postal Service would be $0 million (rounded), computed as follows:

ACS cost savings:	$ 0.3 million
Increased contribution (less incremental discounts):	$ 4.1 million
Discount exposure:	($ 4.4) million

If you do not confirm, please provide the net benefit over the life of the NSA on the assumption that HSBC's return rate for marketing mail were 0.25 percent.

b. If you confirm preceding part a, or if you do not confirm but provide an alternate net benefit of the NSA over the life of the agreement that is not positive, please explain how, under such circumstances — *i.e.*, generating only very clean marketing mail — HSBC could qualify for an NSA that is functionally equivalent to the baseline (Capital One Services, Inc.) NSA? Would one sure-fire option for increasing the computed net benefit to the Postal Service be for HSBC to rent and use dirtier mailing lists prior to entering into an NSA?

c. If very clean Standard marketing mail results in very little ACS cost savings, but would give the Postal Service a higher per piece contribution if such mail were to upgrade to First-Class, what does (or could) the Postal Service offer to induce such mail to use First-Class?

Response

a-b.) Not confirmed. The increased contribution is higher because the return rate is used in calculating the Marketing Unit Cost (page 6), Column 13 and 15. Decreasing the return rate to 1.5 percent would decrease the Current and After Rates Return Adjustment Unit Costs, thus increasing the average contribution for Before and After Rates FCM (page 11).

ACS Cost Savings	$0.3 million
Increased Contribution	$5.1 million
Discount/exposure	$(4.4) million
Total	$1.0 million

I agree that, under the approach used by the Commission to date (i.e. capping cumulative discounts at cumulative ACS cost savings), it would be difficult to design a useful NSA with a mailer that has an extremely low return rate, and remain functionally equivalent to the Capital One NSA. I reject, however, the suggestion that such mailers should or would respond to these circumstances by trying to manipulate the process. It is improbable in the extreme that a

customer would attempt to increase the Postal Service's calculated NSA benefit by intentionally degrading the quality of their acquisition mail. To do so would require purchasing mail lists, paper stock, and printing services (or expending additional resources to perform similar functions in-house) and paying for postage for mail pieces believed to have no probability of reaching their intended recipients, all for the sake of possibly getting small incentives at the margin. Suggesting that this is a sound business strategy would indicate a fundamental misunderstanding of business practices and basic economics.

c.) As indicated above, the link between ACS cost savings and price incentives was artificially created through the imposition of a cap in the Capital One NSA. I believe that, independent of a cap, incentives of the type that exist in the HSBC NSA provide incentives for customers to convert from Standard Mail to First-Class Mail in some instances.

RESPONSE OF POSTAL SERVICE WITNESS DAUER TO INTERROGATORIES OF VAL-PAK

VP/USPS-T1-7.

a. Does the Postal Service have any estimate for the percentage of HSBC's Standard Mail that was undeliverable as addressed ("UAA") in BY 2000, or any fiscal year subsequent to BY 2000? If so, please provide.

b. For the portion of its Standard Mail that HSBC expects to convert to First-Class, does the Postal Service have any estimates of the percentage that is expected to be (i) UAA, (ii) UAA and forwardable, and (iii) UAA and non-forwardable? If so, please provide.

Response

a-b.) The Postal Service does not have any estimate. The Postal Service generally disposes of UAA Standard Mail and does not track the amount by customer.

RESPONSE OF POSTAL SERVICE WITNESS DAUER TO INTERROGATORIES OF VAL-PAK

VP/USPS-T1-8.

a. For the portion of HSBC's Standard Mail that it expects to convert to First-Class, do *your computations of the net benefit to the Postal Service assume, either explicitly or implicitly,* that the percentage of such converted Standard Mail that will be UAA and non-forwardable (*i.e.*, requiring either an electronic or manual return) will be the same as HSBC's existing First-Class marketing mail return rate of 4.5 percent? Please explain fully any response that is not an unqualified affirmative.

b. If your response to preceding part a is affirmative, please explain the basis for assuming that HSBC's Standard marketing mail is neither "cleaner" nor "dirtier" than its First-Class marketing mail.

c. Would you concur that the UAA rate of the NSA recipient's Standard marketing mail was not a relevant consideration in the baseline (Cap One) NSA, but is a relevant consideration in this NSA with HSBC? If you do not concur, please explain why.

d. Where in your testimony do you discuss the UAA rate of HSBC's Standard marketing mail?

e. Please assume that the Standard marketing mail that HSBC converts to First-Class turns out to be much "dirtier" than its existing First-Class marketing mail, and has a return rate of 9.5 percent. Over the life of the NSA, would that eventuality, by itself, tend to increase or decrease the $6.3 million net benefit to the Postal Service that is shown in your testimony at page 16, line 12? Please explain your answer.

f. Please assume that the Standard marketing mail that HSBC converts to First-Class turns out to be much "cleaner" than its existing First-Class marketing mail, and has a return rate of only 1.5 percent. Over the life of the NSA, would that eventuality, by itself, tend to increase or decrease the net $6.3 million benefit to the Postal Service that is shown in your testimony at page 16, lines 12-13? Please explain your answer.

Response

a.) That assumption is implicit.

b.) I do not make the assumption referenced in this question (i.e., that all of HSBC's Standard Mail has the same UAA profile as its First-Class marketing mail): I only assume that the pieces which convert would have that profile.

c.) I do not agree that the UAA rate of all of HSBC's Standard Mail is relevant. See also my *response to part b.*

d.) I do not discuss in my testimony the UAA rate of HSBC's Standard marketing mail.

e-f.) For the relatively small share of HSBC's Standard Mail that witness Harvey has projected will convert to First-Class Mail, if the UAA rate were lower, that would tend to increase the benefit to the Postal Service. Conversely, if the UAA rate were higher, it would tend to decrease the net benefit. However, the situation that this interrogatory implies -- that a customer who

knew which share of its addresses were likely to produce a greater proportion of UAA pieces would be sending them via Standard rather than First-Class Mail – is highly unlikely. Since First-Class Mail pieces are forwardable and returnable free of charge, such a customer would see an immediate and automatic lift in response rates by sending such pieces via First-Class Mail and is therefore more likely to choose First-Class Mail rather than Standard. This implies that for a given customer who is using both First-Class Mail and Standard Mail for advertising, it is likely that the Standard Mail portion is even less likely than the First-Class Mail portion to generate UAA pieces.

RESPONSE OF POSTAL SERVICE WITNESS DAUER TO INTERROGATORIES OF VAL-PAK

VP/USPS-T1-9.

Please refer to your response to Presiding Officer's Information Request No. 1, question 10.

a. Please explain why correction of the ACS pricing anomaly you discuss would "typically be addressed in an omnibus rate case."

b. What are the major reasons why correction of the ACS pricing anomaly you discuss could not be corrected in a mail classification case or a non-omnibus rate case?

c. Please confirm that correction of the ACS pricing anomaly you discuss would promote Postal Service efficiency. If you do not confirm, please explain why the pricing anomaly does not hamper or impede more efficient use of postal resources.

d. Please confirm that correction to the ACS pricing anomaly you discuss would result in the lowest combined cost for the Postal Service and the mailer. If you do not confirm, please explain how the pricing anomaly supports lowest combined cost.

Response

a-b.) It would "typically be addressed in an omnibus rate case" because the size and scope, particularly in terms of the range of potentially affected mailers, are so large. Interim cases tend to be focused on more discrete groups of mailers. Broader matters are usually left for an omnibus case when groups across the entire spectrum of mailers are already involved.

c.) I assume that ACS pricing would only change if it meant improved postal efficiency.

d.) The issues raised by ACS pricing are complicated. In my work, which focuses on NSAs, I have not been requested to consider broader ACS pricing in terms of lowest combined cost, and I have no opinion in that regard.

RESPONSE OF POSTAL SERVICE WITNESS DAUER TO INTERROGATORIES OF VAL-PAK

VP/USPS-T1-10.

On October 27, 2004, the Postal Service published a final rule seeking to clarify the eligibility requirements for First-Class Mail, particularly with respect to personalization of mailings, which will be effective on June 1, 2005 (69 Fed. Reg. 62578), as well as several related Customer Support Rulings. Is it your understanding that either the current or scheduled-to-be-amended Postal Service First-Class eligibility rules or Customer Support Rulings could require some or all of HSBC's current or planned marketing mail to be sent as First-Class Mail?

a. If so, how much of HSBC's current or planned marketing mail would be required to be sent as First-Class Mail?

b. If not, please explain in detail why not.

Response

a-b.) This final rule would not affect HSBC's marketing mail because the only mail would fall into this category are the "convenience checks" and they are currently being mailed as First-Class Mail, and are categorized as operational mail for the purpose of the NSA. Please see witness Harvey's response to OCA/HSBC-T1-7.

Response of Postal Service Witness Dauer to Presiding Officer's Information Request No. 1

2. Witness Dauer proposes a data collection plan based on the Capital One data collection plan. USPS-T-1 Appendix C. The proposed plan omits the collection of data on volume of HSBC Standard Mail solicitations by rate category as was required by the Capital One data collection plan. It also omits a Commission requirement to provide a comparison of the estimated mailer-specific costs, volumes, and revenues with the actual mailer-specific costs, volumes, and revenues. See rule 193(g). Finally, it does not impose a deadline on the periodic submission of reports. See, e.g., PRC Op. MC2004-3 at 85 fn. 49. The addition of the following three statements to the HSBC data collection plan, appropriately placed, would correct for these deficiencies:

> "Volume of HSBC Standard Mail solicitations by rate category."
>
> "A comparison of the estimated mailer-specific costs, volumes, and revenues with the actual mailer-specific costs, volumes, and revenues."
>
> "Each report is to be provided within 120 days after the end of each fiscal year during which the Negotiated Service Agreement is in effect. Items 1, 2, 4 through 7, and 11 are to be reported as monthly data for the previous fiscal year."

Similar changes were incorporated into the Bank One data collection plan. See PRC Op. MC2004-3 at 83-5. Is there any objection (and if so please elaborate) to incorporating the above items into the HSBC data collection plan?

RESPONSE:

The Postal Service would not object to incorporating the above items into the HSBC data collection plan.

Response of Postal Service Witness Dauer to Presiding Officer's Information Request No. 1

3. The Postal Service Request Attachment E-18 identifies the record testimony from the baseline agreement docket, or any previously concluded docket, on which the Postal Service proposes to rely. In Docket Nos. MC2004-3 and MC2004-4, the equivalent attachments referenced Library References from Docket No. R2001-1, specifically: USPS-LR-J-58, J-60 (as revised 11/15/2001), and J-69 (as revised 11/5/2001), and PRC-LR-2, 4, and 7. Does the Postal Service intend to rely on these same Library References in the HSBC docket?

   Note: The PRC Library References technically are not "record evidence." However, the Commission found it helpful when the Postal Service included these items in previous dockets under this data requirement item. It is beneficial to have all sources listed in one place. Also, this provides potential intervenors with a single, concise list of materials from previous dockets to be considered in making an intervention decision in the instant docket. (This more inclusive interpretation of rule 196(a)(3) is suitable for comment in ongoing rulemaking Docket No. RM2005-2.)

RESPONSE:

The Postal Service intended to rely on the same materials (including the Library References identified in the question) in this docket as in Docket Nos. MC2004-3 and MC2004-4, and the omission of those Library References from Attachment E was inadvertent.

Response of Postal Service Witness Dauer to Presiding Officer's Information Request No. 1

5. For the following question refer to the two attached tables (MC2002-2, Attachment A, page 2 and MC2005-2, Appendix A, page 5).

In the baseline Negotiated Service Agreement (Docket No. MC2002-2), the calculation of estimated unit costs by rate category is presented in USPS-T-3, Attachment A, page 2. The "TY 2003 Total Unit Cost" in column 14 is the sum of Mail Processing, Delivery and "Other" unit costs. Mail Processing and Delivery costs are taken directly from PRC library references from the most recent omnibus rate case (Docket No. R2001-1), and the remaining "Other" unit costs are calculated by subtracting the weighted average unit costs of mail processing (column 11) and delivery (column 12) from the total unit "TY 2003 Total Unit Cost" in column 10. This ensures that the two "TY 2003 Total Unit Costs" (columns 10 and 14) are equal. Because the total unit cost in column 10 is the cost for presorted mail in the First-Class Mail Letters subclass (all shapes), the weighted average costs used in the calculation of "Other Unit Cost" include the costs of automation presort flats.

In the two subsequent Negotiated Service Agreements, the unit costs for each rate category from the baseline case were adopted. (See MC2004-3, USPS-T-1, Appendix A at 4-5 and MC2004-4, USPS-T-1, Appendix A at 4-5.)

In the current proposal, the weighted average mail processing and delivery costs are recalculated to reflect only the letter-shaped rate categories. Then, the new weighted average mail processing and delivery costs are subtracted from the total unit cost of presorted mail in the First-Class Letters subclass (all shapes). Consequently, the "Other" costs are calculated as the difference between the total cost of all shapes and the mail processing and delivery costs of letter-shaped pieces. (See USPS-T-1, Appendix A at 5-6.)

Please explain the rationale for the change in the "TYBR 2003 Other Unit Cost" from the baseline and prior functionally equivalent Negotiated Service Agreements.

RESPONSE:

There was no rationale for the change in the "TYBR 2003 Other Unit Cost" from the baseline and prior functionally equivalent Negotiated Service Agreements to the HSBC NSA model. The .021 figure was inadvertently pulled

from a preliminary version of an earlier model, in which that figure was later corrected to .018 prior to filing. Appropriate revisions to Appendix A to my testimony are being filed separately.

Response of Postal Service Witness Dauer to Presiding Officer's Information Request No. 1

MC2002-2, Attachment A, page 2

CAPITAL ONE FIRST-CLASS MAIL PRESORT LETTERS/FLATS UNIT COST ESTIMATES

Capital One Solicitation Return Percentage =	9.6%	(1)
Capital One Statement Return Percentage =	1.2%	(2)
Average Presort Letters Return Percentage =	1.23%	(3)
Before Rates Customer Mail Volume =	640,000,000	(4)
Before Rates Solicitation Mail Volume =	768,000,000	(5)
Manual Returns Unit Cost =	$0.535	(6)
Electronic Returns Unit Cost =	$0.332	(7)
Address Change Service (ACS) Success Rate =	85.0%	(8)
Contingency Factor =	1.030	(9)

	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)	(21)	(22)	(23)
	DOCKET NO. R2001-1 PRC FIGURES - NATIONWIDE MAIL MIX							DOCKET NO. R2001-1 PRC FIGURES - CAPITAL ONE MAIL MIX						
Rate Category	TY 2003 Total Unit Cost (Dollars)	TY 2003 Mail Proc Unit Cost (Dollars)	TY 2003 Delivery Unit Cost (Dollars)	TY 2003 Other Unit Cost (Dollars)	TY 2003 Total Unit Cost (Dollars)	FY 2001 Mail Volume (Pieces)	FY 2001 Mail Volume (Percent)	TY 2003 Total Unit Cost (Dollars)	FY 2001 Mail Volume (Pieces)	FY 2001 Mail Volume (Percent)	Current Returns Adjustment Unit Cost (Dollars)	Current w/Rets Adj Total Unit Cost (Dollars)	After Rates Returns Adjustment Unit Cost (Dollars)	After Rates w/Rets Adj Total Unit Cost (Dollars)
FIRST-CLASS MAIL LETTERS														
Nonautomation Presort Letters		$0.167	$0.063	$0.015	$0.244	3,702,479,000	7.84%	$0.244	57,664,158	5.01%				
Automation Presort Letters														
Automation Mixed AADC		$0.055	$0.045	$0.016	$0.116	2,634,662,000	5.58%	$0.116	58,754,928	5.10%				
Automation AADC		$0.046	$0.044	$0.016	$0.107	2,820,125,000	5.97%	$0.107	62,890,886	5.46%				
Automation 3-Digit		$0.042	$0.043	$0.016	$0.104	22,474,261,000	47.60%	$0.104	538,406,052	46.78%				
Automation 5-Digit		$0.032	$0.041	$0.018	$0.091	14,038,059,000	29.73%	$0.091	369,430,335	32.10%				
Automation Carrier Route		$0.023	$0.064	$0.016	$0.103	1,020,556,000	2.16%	$0.103	63,511,973	5.52%				
Automation Presort Flats														
Automation Mixed ADC		$0.448	$0.095	$0.019	$0.562	52,631,000	0.11%	$0.562	33,247	0.00%				
Automation ADC		$0.348	$0.095	$0.018	$0.461	28,100,000	0.06%	$0.461	16,737	0.00%				
Automation 3-Digit		$0.348	$0.095	$0.018	$0.461	187,788,000	0.40%	$0.461	318,683	0.03%				
Automation 5-Digit		$0.235	$0.095	$0.018	$0.348	254,253,000	0.54%	$0.348	5,076	0.00%				
WEIGHTED AVERAGE / TOTAL	$0.115	$0.052	$0.045	$0.018	$0.115	47,214,206,000	100.00%	$0.108	1,151,030,386	100.00%	$0.0243	$0.1320	$0.0153	$0.1229

Total Unit Cost Estimates, Including Contingency = $0.1359 Current (24); $0.1266 After Rates (25)

(1) Capital One witness Jean
(2) Capital One witness Jean
(3) USPS-LR-J-69 (FCM UAA % from Table 4.2 allocated by Return to Sender % from Table 4.3.3)
(4) COS-T-2, Exhibit 6
(5) COS-T-2, Exhibit 6
(6) "MANUAL RETURNS UNIT COST" Spreadsheet
(7) "ELECTRONIC RETURNS UNIT COST" Spreadsheet
(8) USPS witness Wilson
(9) Docket No. R2001-1
(10) Docket No. R2001-1, PRC LR-2, Volume 4, "TYBR", page 3
(11) Letters: Docket No. R2001-1, PRC LR-4, "FCLETPRCFA.XLS", page 1
Flats: Docket No. R2001-1, PRC LR-4, "FCFLATSPRCFA.XLS", page 1
(12) Docket No. R2001-1, PRC LR-7, Page 2
(13) (10) - Weighted Average(11) - Weighted Average(12)
(14) (11) + (12) + (13)
(15) FY 2001 Billing Determinants
(16) (15) / [Sum (15)]
(17) Line Item (14), Total - Allocated by (19)
(18) Attachment A, Page 1
(19) (18) / [Sum (18)]
(20) (6) * [(4) * [(2) - (3)] + (5) * [(1) - (3)]] / [(4) + (5)]
(21) Sum (17) + (20)
(22) { [(8) * (7) + (1 - (8)] * (6)] * [(5) * [(1) - (3)]] + (6) * (4) * [(2) - (3)]] / [(4) + (5)] - (3) * ((6) -(7)) * (8) * (5) / ((4) + (5))
(23) Sum (17) + (22)
(24) (21) * (9)
(25) (23) * (9)

Response of Postal Service Witness Dauer to Presiding Officer's Information Request No. 1

MC2005-2, Appendix A, page 5

HSBC North America Holdings Inc. Model
Negotiated Service Agreement
Appendix A, page 5

Rate Category	DOCKET NO. R2001-1 PRC FIGURES - NATIONWIDE MAIL MIX								
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
	TYBR 2003 Total Unit Cost (Dollars)	TYBR 2003 Mail Proc Unit Cost (Dollars)	TYBR 2003 Delivery Unit Cost (Dollars)	TYBR 2003 Other Unit Cost (Dollars)	TYBR 2003 Total Unit Cost (Dollars)	FY 2005 Total Unit Cost Dollars	BY 2000 Mail Volume (Pieces)	FY 2003 Mail Volume (Pieces)	FY 2003 Mail Volume (Percent)
FIRST-CLASS MAIL LETTERS									
Nonautomation Presort Letters		0.163	0.063	0.021	0.247	0.257	2,748,077,000	2,673,332,468	5.8%
Automation Presort Letters									
Automation Mixed AADC		0.055	0.045	0.021	0.121	0.130	2,534,845,824	2,820,696,092	6.1%
Automation AADC		0.046	0.044	0.021	0.110	0.119	2,660,656,175	2,636,650,800	5.7%
Automation 3-Digit		0.042	0.043	0.021	0.106	0.115	21,812,339,000	22,571,247,888	46.6%
Automation 5-Digit		0.032	0.041	0.021	0.093	0.101	12,720,447,000	14,011,024,117	32.1%
Automation Carrier Route		0.021	0.064	0.021	0.105	0.114	1,075,333,000	802,292,628	1.7%
WEIGHTED AVERAGE / TOTAL	$0.115	0.050	0.045	0.021	0.111	0.120	44,562,599,000	46,415,243,896	100.0%

Rate Category	HSBC MAIL MIX						
	(10)	(11)	(12)	(13)	(14)	(15)	(16)
	TY 2005 Total Unit Cost (Dollars)	FY 2004 Mail Volume (Pieces)	FY 2004 Mail Volume (Percent)	Current Returns Adjustment Unit Cost (Dollars)	Current w/Rets Adj Total Unit Cost (Dollars)	After Rates Returns Adjustment Unit Cost (Dollars)	After Rates w/Rets Adj Total Unit Cost (Dollars)
FIRST-CLASS MAIL LETTERS							
Nonautomation Presort Letters	0.267	9,805,861	2.2%				
Automation Presort Letters							
Automation Mixed AADC	0.130	31,387,770	7.1%				
Automation AADC	0.119	41,768,164	9.5%				
Automation 3-Digit	0.115	264,042,110	60.1%				
Automation 5-Digit	0.101	78,242,286	17.8%				
Automation Carrier Route	0.114	14,351,645	3.3%				
WEIGHTED AVERAGE / TOTAL	0.117	439,597,836	100.0%	$ (0.0055)	0.112	$ (0.0055)	0.112
Total Unit Cost Estimates, Including Contingency =					(17) 0.115		(18) 0.115

(1) Docket No. R2001-1, PRC LR-2, Volume 4 "TYBR" page 3
(2) Docket No. R2001-1, PRC LR-4 "FCLETPRCFA.XLS", page 1
(3) Docket No. R2001-1, PRC LR-7 Page 2
(4) (1) - Weighted Average(2) - Weighted Average(3)
(5) (2) + (3) + (4)
(6) (5) * (1 + inflation cost adjustment factor) * (1 + Inflation cost adjustment factor)
(7) Docket No. R2001, PRC, LR-4, FCM base year volumes from FCM letter model
(8) Revenue, Pieces, and Weight (RPW) Report
(9) (8) / [Sum (8)]
(10) Line Item (6), Weighted Average weighted by percentages in (12)
(11) CBCIS 2004 HSBC Volume Data
(12) (11) / [Sum (11)]
(13) (Manual Letter Returns Unit Cost * After Rates Statement Mail) * (Statement Mail Return Forecast - USPS FCM Avg. Return Rate) / After Rates Statement Mail
(14) (10) + (13)
(15) (Manual Letter Returns Unit Cost * After Rates Statement Mail) * (Statement Mail Return Forecast - USPS FCM Avg. Return Rate) / After Rates Statement Mail
(16) (10) + (15)
(17) (14) * Contingency Factor (Assumptions)
(18) (16) * Contingency Factor (Assumptions)

Response of Postal Service Witness Dauer to Presiding Officer's Information Request No. 1

6. USPS-T-1 states at page 13:

> The Postal Service evaluated the proposed cap using Commission's logic of the Docket MC2004-4 to establish its position while in negotiations with HSBC. The Postal Service used a 100 percent pass through of the ACS cost savings of $8.1 million plus the competitive adjustment given in Docket MC2004-04 of 10.09 percent. This equals $8.9 million ($8.1 million + $.8 million).

(a) Please refer to the following table. Following the Commission's methodology for calculating the value of the stop-loss cap used in Docket No. MC2004-4 (at 100 percent pass through) and then increasing this value by 10.09 percent, please verify that the calculated cap would equal $8.727 million. See PRC Op. MC2004-4 at 38, Table 6.

(b) Please verify that the Postal Service then adds an additional [($9 million / $8.9 million) – 1] or 1.12 percent to its calculated value, which when similarly added to the calculated value above would result in a final stop-loss cap value of $8.825 million.

RESPONSE:

For purposes of preparing for negotiation of the stop-loss cap provision, I used in my calculations the same contingency factor (1.03) that was applied to all other cost calculations in my models. The result of including the contingency factor was the $8.1 million estimate of ACS costs savings referenced in my testimony, as noted above. In contrast, the stop-loss calculation shown on the attached page does not include the contingency, and the resulting ACS cost savings estimate at breakeven volumes is $7.9 million. The only difference is the inclusion or exclusion of the contingency factor. To keep the stop-loss cap analysis comparable to the other financial analyses on which the NSA is based, I believe it necessary to include the contingency factor, although I can verify that if

the contingency were to be omitted, the ACS cost savings estimate would be $7.9 million, as shown on the attached page. In any event, however, viewed in conjunction with the allowance made in the Discover NSA case with respect to a negotiated cap above the estimated ACS savings amount, I consider a negotiated cap of $9 million for this case to be equally reasonable whether the estimated ACS savings at breakeven volumes is $7.9 million, or $8.1 million. The cap amount was negotiated between the parties, not reached by application of a rigid formula, as perhaps implied in the question. The calculations set forth in the above-quoted portion of my testimony were used for purposes of evaluating the reasonableness of the negotiated cap.

Response of Postal Service Witness Dauer to Presiding Officer's Information Request No. 1

Table 1. Calculation of Stop-Loss Cap

	Year 1	Year 2	Year 3	Total NSA
A. Effects of ACS (Savings Estimate)				
First-Class Mail Marketing Letters:				
Avg. Savings from Returns	0.0088	0.0092	0.0096	
Avg. Savings (Cost) from Forwards	0.0000	0.0000	0.0000	
Total Avg. Savings from ACS	0.0088	0.0092	0.0096	
Before Rates Volume	195,735,891	297,522,231	361,504,700	
Net Contribution Gain from ACS (Savings)	**1,731,501**	**2,737,190**	**3,458,859**	**7,927,549**
B. Effects of Lost Contribution (Revenue Leakage)				
Before Rates First-Class Volume	678,757,162	815,929,752	917,974,638	
Volume Threshold for Discounts	615,000,000	725,000,000	810,000,000	
Before Rates Volume Eligible for Discounts	63,757,162	90,929,752	107,974,638	
Average Discount on "Exposed" Volume	0.0272	0.0301	0.0320	
Total Discounts on Before Rates Volume (Leakage)	**(1,731,501)**	**(2,737,190)**	**(3,458,859)**	**(7,927,549)**
Net Increase in Contribution (before rates volume)	-	-	-	-
Savings from ACS at Break-Even Volume	7,927,549 /1			
Pass-through Percentage	100%			
Stop-Loss Cap Amount	**7,927,549**			
Ratio of DFS "Competitive Cap" to PRC Cap	1.1009			
Cap with "Competitive Adjustment"	8,727,439			
Percentage increase to round up to $9 million	1.12%			
Cap with "Competitive Adjustment" and rounding effect	8,825,187			

1/ This figure reflects the methodology employed by the Commission in Docket Nos. MC2004-3 and MC2004-4.

Response of Postal Service Witness Dauer to Presiding Officer's Information Request No. 1

7. In Docket Nos. MC2004-3 and MC2004-4, the Postal Service's estimates of cost savings from the avoidance of physical returns were modified by the application of a contingency factor to the estimated total savings in each year of the agreement. In contrast, witness Dauer applies the contingency factor to the costs of physical and electronic returns (i.e., at the beginning of the calculation, instead of the end). Please explain the rationale for this change in methodology. Include a discussion of the impact on the estimated before and after rates unit costs of HSBC's solicitations and operational First-Class Mail. Specifically, address the implications of using the contingency adjusted costs of physical and electronic returns in the calculation of cost estimates that are themselves adjusted by the contingency factor.

RESPONSE:

Because of corrections filed on the same day as this question to the model in Appendix A of my testimony, I believe that the circumstances described in this question have been resolved and are no longer applicable.

Response of Postal Service Witness Dauer to Presiding Officer's Information Request No. 1

9. Please refer to USPS-T-1 at 13-17 and Docket No. MC2002-2, Tr. 2/334. Witness Dauer accepts the forecasts of before-rates volume, after-rates volume and estimated return rates provided by HSBC witness Harvey (HSBC-T-1) and characterizes the after-rates volume estimates as conservative. Please provide any independent analysis done by the Postal Service to evaluate the reasonableness of the mailer-provided forecasts of: (a) before-rates volumes, (b) after-rates volumes, and (c) estimated return rates.

RESPONSE:

The Postal Service currently reviews industry and analysis reports to determine if the company's forecasts are consistent with available data about its forecasts and trends. The Postal Service currently does not do any independent volume or return rate analysis to compare against the mailer-provided forecasts. I regard Mr. Harvey's estimates of the after-rates effects of the discounts as "conservative" in light of the potential range of effects discussed in the testimony of witness Buc (BOC-T-2) in the Bank One case (Docket No. MC2004-3).

Response of Postal Service Witness Dauer to Presiding Officer's Information Request No. 1

10. Please Refer to Docket No. MC2002-2, Opinion para. 3050-51, and Tr. 9/1868 and 1876. In that case, the Postal Service indicated that it was reviewing possible pricing approaches to physical return of mail and electronic equivalents to consider alternative ways to address the apparent pricing anomaly with respect to the return of undeliverable-as-addressed First-Class Mail. Please update the Commission on the status of this review and how it affected the Postal Service's decision to enter into the proposed agreement with HSBC.

RESPONSE:

The Postal Service remains committed to re-pricing the ACS services currently offered in a manner which better reflects the value of the service to customers and the costs of providing ACS across different classes of mail. To address any anomalies in the pricing of the ACS service, the Postal Service would need to confront specific classification and cost issues that would typically be addressed in an omnibus rate case. Published reports, however, have indicated the postal management is considering a rate filing that would not necessarily address the full range of issues typically addressed in an omnibus rate filing. If that is the case, the next rate filing may not be conducive to resolution of the types of issues referred to in this question, and those issues may not be addressed until a subsequent omnibus rate case.

It should be noted, however, that even with revised pricing, the possibility remains that certain mailers would not adopt ACS. The existing NSAs require mailers to exceed current Postal Service requirements regarding mail preparation. The Postal Service may require ACS participation for First-Class solicitation mailers as a requirement towards future NSAs. On balance, however,

the Postal Service concluded that none of these matters posed sufficient reasons to decline to proceed now with an NSA for HSBC that was functionally equivalent to those currently existing for three similar mailers.

RESPONSE OF POSTAL SERVICE WITNESS DAUER TO POIR NO. 2

1. Refer to USPS-T-1 at 11 (revised March 11, 2005). Witness Dauer explains that one condition necessary to trigger an upward adjustment of the discount thresholds is that HSBC's Standard Mail volume for the year in question exceeds its forecast by at least 5 percent.
   (a) Please refer to Attachment F to the Request at page 5, and confirm that the Standard Mail volume forecasts to which witness Dauer refers are 605 million for Year 1 and 596 million for Year 2. If so, identify the source of the forecasts, explain their development, and provide any independent analysis and/or calculations performed by the Postal Service to evaluate their reliability. If not, provide the correct forecasts, identifying their source, explaining their development and including any independent analysis and/or calculations performed by the Postal Service to evaluate their reliability.
   (b) Please confirm that the estimates identified in part (a) are before rates volumes, and that the after rates volumes would be 16 million lower for Year 1 and 20 million lower for Year 2.
   (c) Please confirm that the estimates identified in part (a) are for letter-shaped Standard Mail only. If not, provide the forecast volumes separately for each shape.
   (d) Refer to HSBC-T-1 at page 6, Table 1. Witness Harvey presents historical First-Class Mail volumes for 2002, 2003, and 2004. Please provide HSBC's historical Standard Mail volumes for the same years, separately for each shape.

RESPONSE:

The primary response to this item is being provided by HSBC. The following, however, responds to that portion of subpart (a) which inquires about the Postal Service's evaluation of the Standard Mail forecasts provided by HSBC. As it does with a potential NSA partner's First-Class Mail volume forecast, in situations such as the HSBC NSA in which the Standard Mail forecast is relevant as well, the Postal Service currently reviews industry and analysis reports to determine if the company's forecasts of both categories of mail are consistent with available data about its forecasts and trends.

REVISED: MARCH 11, 2005

USPS-T-1

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

RATE AND SERVICE CHANGES TO IMPLEMENT FUNCTIONALLY EQUIVALENT NEGOTIATED SERVICE AGREEMENT WITH HSBC NORTH AMERICA HOLDINGS INC.

Docket No. MC2005-2

DIRECT TESTIMONY
OF
JESSICA A. DAUER
ON BEHALF OF THE
UNITED STATES POSTAL SERVICE

TABLE OF CONTENTS

AUTOBIOGRAPHICAL SKETCH

My name is Jessica Ann Dauer. I joined the Postal Service in 2003 and am currently an Economist in the Pricing Strategy group. I provided financial analysis support for the Bank One Corporation Negotiated Service Agreement (NSA) filing, Docket No. MC2004-3, and the Discover Financial Services NSA filing, Docket No. MC2004-4. I am also responsible for the beginning process stages for NSAs.

I was part of the Postal Service's negotiating team that developed the NSA with HSBC North American Holdings Inc. and am responsible for all financial analyses presented in the Postal Service filing. In addition, I provided negotiation and financial analysis support for both the Bank One NSA and Discover NSA. This is my first appearance before the Commission.

I earned a Bachelor's Degree in Marketing and Economics from Lynchburg College and a Master's of Business Administration (MBA) from the Strayer University with honors. While pursing my MBA, I worked full time with the Postal Service.

I. PURPOSE AND SCOPE OF TESTIMONY

The purpose of my testimony is to describe and analyze the policy and business considerations that support the Postal Service's negotiated service agreement (NSA) with the subsidiaries of HSBC North America Holdings Inc. In this testimony, I refer to the subsidiaries of HSBC North America Holdings Inc. that operate in the United States as HSBC. The HSBC NSA is submitted as functionally equivalent to the Docket No. MC2002-2 baseline NSA with Capital One. Thus, in accordance with 39 C.F.R. § 3001.196, my testimony will include a detailed explanation of how the HSBC NSA is functionally equivalent to the baseline agreement, and will describe the differences between the HSBC NSA and the baseline agreement. My testimony will also analyze the financial impact of the NSA on the Postal Service over the three-year duration of the agreement, the fairness and equity of the NSA in regard to other users of the mail, and the fairness and equity of the NSA in regard to the competitors of the parties to the NSA. Finally, I will explain why functionally equivalent NSAs are important to the business goals of the Postal Service.

My testimony will show that (1) the HSBC NSA primarily rests on the same substantive functional elements as the Capital One NSA and provides comparable benefits; (2) the HSBC NSA is functionally equivalent to Capital One, and therefore this NSA has a comparable competitive impact; and (3) the HSBC NSA conforms to the relevant pricing and classification criteria of the Postal Reorganization Act. My testimony will also explain how the HSBC NSA will improve the financial position of the Postal Service.

My testimony relies on the concurrently filed testimony of HSBC witness John H. Harvey (HSBC-T-1), which is similar to the testimony provided by Capital One in Docket No. MC2002-2. On behalf of the Postal Service, I have reviewed Mr. Harvey's testimony, and affirm that such testimony may be relied upon in presentation of the Postal Service's direct case.

Appendix A to my testimony presents the model that calculates the financial impacts of the NSA. This model reproduces the calculations provided in Attachments (1), (2), and (B) of Witness Crum's testimony (USPS-T-3) in Docket No. MC2002-2. Appendix B explains the similarities and differences between both models. It is important to note that the underlying principles for calculating Postal Service contribution in the new format remain the same. Appendix C contains the proposed Data Collection Plan, which is based on the Data Collection Plan for the baseline Docket No. MC2002-2.

II. INTRODUCTION AND SUMMARY

The HSBC NSA creates a win-win situation for both HSBC and the Postal Service by providing HSBC with a direct economic benefit of up to $9 million in postage discounts, and allowing the Postal Service to capture costs savings and increased contribution, which minimizes any potential risk of harm to mailers not party to the agreement. This win-win situation is created by three similar but not identical elements: the address correction element, the declining block rate volume discount element, and the negotiated cap element.

III. THE IMPORTANCE OF NSAS AND FUNCTIONALLY EQUIVALENT AGREEMENTS

A. Background and Strategic Advantages of NSAs

In Docket No. MC2002-2, the Commission found that, when the concepts underlying negotiated pricing and declining block rates are applied fairly, benefits can accrue, not only to the customer and to the Postal Service, but also to all other postal customers. As witness Bizzotto pointed out, the Postal Service considers negotiated pricing a natural extension of its long-standing practice of seeking innovations in pricing. (MC2002-2) USPS-T-1 at 2-5. Used appropriately, negotiated pricing facilitates incentives for additional mail volume that benefits the Postal Service, its business partner, and all users of the Postal Service, through the resulting additional contribution to institutional costs. Given the economic pressures described below, NSAs represent one tool that can help to mitigate the risk that continued erosion of existing First-Class Mail volume will lead to higher than necessary rate and fee increases in the future.

In its opinion in Docket No. MC2002-2, the Commission also concluded that the "Postal Service should ensure that '[t]he negotiated rate-and-service package is made available on the same terms to other potential users willing to meet the same conditions of service." PRC Op., Docket No. MC2002-2, ¶ 7004, p. 136. To address this concern in the Capital One case, the Postal Service, Capital One, the Office of Consumer Advocate (OCA), and many intervenors entered into a stipulation and agreement that identified the terms and conditions that must be included for an agreement to be considered comparable to Capital One. The Postal Service codified these elements in DMM G911. The HSBC NSA meets these criteria and affirms the Postal Service's commitment to extend the Capital One NSA's terms and conditions to other mailers.

B. The Importance of Functionally Equivalent NSAs to the Postal Service

Functionally equivalent NSAs are important to the Postal Service because they extend the benefits of baseline agreements to other customers. The Commission's procedural framework for functionally equivalent cases promises to ensure that this objective can be achieved efficiently in an expedited proceeding, where unnecessary controversy and duplication of effort can be minimized. These procedural goals, in turn, support the related objectives of minimizing the transaction costs involved in pursuing NSAs, reinforcing the financial incentives embodied in NSAs, and thereby promoting a viable and productive NSA process.

Expedited litigation and subsequent implementation of the adjustments proposed in this case would benefit both the Postal Service and HSBC under the specific terms of the HSBC NSA. If the proposed adjustments are recommended and approved, the Postal Service would realize immediate benefit from the agreement in terms of ACS savings. If this case, however, were to be litigated as a baseline NSA under the Commission's rules, the protracted proceedings would delay the Postal Service's ability to capture the ACS savings. From the customer's perspective, furthermore, lengthy litigation would result in higher costs as well as delayed business benefits. For smaller mailers this cost can become prohibitive, in effect lowering the customer's valuation of the NSA, perhaps making it economically undesirable. Moreover, lengthy proceedings would add to the risk that the business environment might change in such a way that neither the Postal Service nor HSBC could take advantage of the NSA.

In Docket No. MC2002-2, considerable attention was focused on the risks associated with declining block rates. Witness Panzar addressed the technical risks

associated with non-linear pricing, and the OCA focused on the risks inherent in providing volume-based incentives in a future period. A number of participants suggested various mechanisms for mitigating these risks, implying that the risk of change might be greater than the risk of doing nothing.

Competition from electronic alternatives, increasing cost pressure on business customers, and a recent period of economic sluggishness have contributed to a stagnating of demand for First-Class Mail over the last several years. At the same time, household growth continues to lead to expansion of the Postal Service's delivery network. While recent productivity gains have been remarkable, there continues to be pressure on the Postal Service to define ways to continue to fund its large and growing universal service obligation. In the absence of new ways for the Postal Service to generate additional volumes and revenues, USPS customers will likely be asked to absorb price increases in the future.

In this environment, the Postal Service considers to be of critical important the ability to negotiate individual price agreements that are consistent with the Act, and to implement them through rate and classification changes. Procedures linking baseline agreements with their functionally equivalent offspring will help ensure that the benefits of the baseline agreements can be efficiently extended to similar, but distinct, relationships with other mailers. Promoting functionally equivalent NSAs will also mitigate the concern that a baseline NSA might have adverse competitive impacts.

IV. THE HSBC NSA IS FUNCTIONALLY EQUIVALENT TO THE CAPITAL ONE NSA

The HSBC NSA fully meets the guidelines outlined in the Commission's Order No. 1391 (RM2003-5) for functionally equivalent NSAs. The HSBC NSA contains the

same functional elements as the Capital One baseline NSA (*e.g.*, declining block rates and address correction elements, Order 1391 at 50), and will produce comparable benefits for the Postal Service. Any differences between the HSBC NSA and the Capital One NSA do not detract from HSBC's status as functionally equivalent.

A. The HSBC NSA Contains the Same Functional Elements as in the Capital One NSA

The HSBC NSA rests on the same substantive functional elements as the Capital One NSA. First, as in the Capital One agreement, the Postal Service's agreement with HSBC calls for the implementation of incentives in the form of declining block rates, according to the schedule outlined below. The incentives are applied only to incremental volume above the negotiated threshold. In other words, no incentive would be applied to the first 615 million pieces in the initial year; an incentive of 2.5 cents would be applied to the next 40 million pieces, then 20 million pieces, etc.:

Year 1 Volume Block	Incremental Incentives
615,000,001 – 655,000,000	2.5¢
655,000,001 – 675,000,000	3.0¢
675,000,001 – 695,000,000	3.5¢
695,000,001 – 715,000,000	4.0¢
715,000,001 – 735,000,000	4.5¢
735,000,0001 – above	5.0¢

Year 2 Volume Block	Incremental Incentives
725,000,001 – 765,000,000	2.5¢
765,000,001 – 785,000,000	3.0¢

785,000,001 – 805,000,000	3.5¢
805,000,001 – 825,000,000	4.0¢
825,000,001 – 845,000,000	4.5¢
845,000,0001 – above	5.0¢
Year 3 Volume Block	Incremental Incentives
810,000,001 – 850,000,000	2.5¢
850,000,001 – 870,000,000	3.0¢
870,000,001 – 890,000,000	3.5¢
890,000,001 – 910,000,000	4.0¢
910,000,001 – 930,000,000	4.5¢
930,000,0001 – above	5.0¢

Considering these incentives and the testimony of witness Harvey (HSBC-T-1) regarding the volume response of HSBC to the proposed incentive structure, the Postal Service expects HSBC's use of First-Class Mail to increase as a result of the incentives, providing additional net contribution to the Postal Service.

Second, as with the Capital One NSA, the HSBC agreement contains an address correction element, which creates further cost savings for the Postal Service. HSBC has agreed that the Postal Service can convert the physical return of its undeliverable-as-addressed (UAA) marketing mailpieces into electronic address correction information through the computerized ACS system. It is the same ACS system that was described more fully in the testimony of witness Wilson in Docket No. MC2002-2. USPS-T-4 at 2-7. For discussion of the negotiated cap, see Section VII, *infra*.

B. The HSBC NSA Provides the Postal Service a Comparable Benefit

In discussing the NSA rules governing functionally equivalent agreements, Order No. 1391 stated that the Commission would go beyond an evaluation of the functional elements and examine whether the agreement provides a comparable benefit to the Postal Service. Order 1391 at 51. For example, the Commission stated that an agreement that is functionally equivalent to Capital One would need to have ACS cost savings. The ACS cost savings that will result from the HSBC NSA are significant since over 4.75 percent of HSBC's First-Class Mail solicitation volume is currently physically returned. See Appendix A, p. 1. Also, as in Capital One, the HSBC NSA will generate contribution from new First-Class Mail volume. *Id.* at 1, 10, 11.

C. Other Terms and Conditions of the HSBC NSA

The HSBC NSA incorporates other terms and conditions found in the Capital One NSA. The agreement waives the seal against postal inspection of mail; requires HSBC to prepare mail under applicable standards and to enhance its address management practices; includes a transaction penalty; and contains a provision for HSBC to make necessary records and data available to the Postal Service to facilitate and monitor compliance. It also enables the Postal Service to cancel for failure by the mailer to provide accurate data, to present properly prepared and paid mailings, to comply with a material term of the NSA, or to use the NSA. See Request, Attachment F.

D. New Terms and Conditions in the HSBC NSA

By their nature, individual service relationships with the Postal Service reflect the inherent differences among mailers. The ability to develop a customer-specific NSA

allows the Postal Service to address these differences directly, and to develop an agreement that best satisfies the needs of an individual customer and the Postal Service. By improving overall revenue contribution to the Postal Service, such agreements in turn benefit all postal customers.

The exact declining block rates in the HSBC NSA do not match those in the Capital One NSA, although they are similar. The thresholds, incremental blocks, and starting incentives are unique to the HSBC NSA. However, the incentive structure remains the same as in the Capital One NSA, and is the result of a negotiated agreement between the customer and the Postal Service.

In addition, the HSBC NSA incorporates three customer-specific terms not found in the Capital One NSA: negotiated out-year thresholds, an annual adjustment mechanism to the negotiated threshold, and a negotiated cap. As explained below, none of the terms alters the functionally equivalent status of the HSBC NSA.

The first customer-specific term is the set of negotiated thresholds in the out-years. The Postal Service and HSBC negotiated individual thresholds and incentives for each of the three years of the NSA. These enabled the Postal Service to minimize its discount exposure (leakage) against HSBC's high growth rates, while retaining the ability to give HSBC incentives to stretch its First-Class Mail volumes above what they otherwise might be. In previous agreements, the thresholds remained essentially constant throughout the agreement, but in this NSA the negotiated individual thresholds were needed to satisfy both the Postal Service's needs and HSBC's circumstances.

The second customer-specific term is the annual threshold adjustment. As noted, among other objectives, this NSA is intended to create incentives for HSBC to

increase First-Class Mail marketing volumes over the duration of the agreement. However, because HSBC's forecasts reflect high growth rates for both statement and marketing volume, it is possible that actual volumes levels in any given year could materially deviate, having an unintended consequence of diminishing the incentives for new marketing mail volume. For example, if there were a substantial volume shortfall in an early year of the agreement, HSBC may find it exceedingly difficult in later years even to approach the lowest volume threshold set for discounts in those years. If HSBC has no chance to qualify for discounts, those discounts cannot act to encourage volume growth. Alternatively, if volume levels increase in early years beyond what has been forecasted, HSBC might not have to stretch in later years to obtain the higher discounts levels, and the Postal Service would be facing increased discount exposure. In either circumstance, the multi-tiered threshold/discount structure would be unlikely to achieve its intended purpose: to provide an incentive for increasing First-Class Mail volume.

The annual threshold adjustment serves to protect against deviations from the forecasts by including provisions for either upward or downward threshold adjustments in the years following the first year of the agreement (the out-years). The downward adjustment operates such that, if HSBC's total First-Class Mail volume in either the first or second year (YR_n) of the agreement is more than 15 percent below the before rates forecast of that year, then the next year's threshold (YR_{n+1}) would be decreased by a percentage amount equal to the amount by which the volume shortfall exceeds 15 percent. For example, under the HSBC mechanism, if the Year 1 actual volume was 18 percent below the before rates forecast, then the Year 2 thresholds would be decreased by 3 percent (18 -15) to 703 million. Since the adjustment is intended to address only

major volume differences, the trigger point for any downward adjustment is a 15 percent deviation from the forecast.

The same type of mechanism works for increasing the thresholds, when appropriate. If HSBC's First-Class Mail volume in either the first or second year (YR_n) of the agreement is more than 20 percent greater than the before rates forecast of that year, and HSBC's Standard Mail volume for YR_n exceeds its forecast by 5 percent or greater, then the next year's threshold (YR_{n+1}) would be increased by the percentage difference between the actual First-Class Mail volume and the before rates forecast, minus 15 percent. For example, if HSBC's actual First-Class Mail volume is 23 percent greater than the before rates forecast in Year 1, and the Standard Mail volume *simultaneously exceeded its forecast* by 5 percent or more, then in Year 2, the base threshold would increase by 8 percent (23 – 15) to 783 million.

The purpose of including Standard Mail volume performance in the trigger mechanism for the upward adjustment is to attempt to distinguish situations in which the observed growth in First-Class Mail volume is primarily a response to the incentives of the NSA from those situations in which the observed growth is primarily due to other factors. Stated alternatively, the intent is to separate variances in the after rates forecasts from variances in the before rates forecast. Since the expectation is that additional pieces of First-Class Mail resulting from the discounts would be pieces converting from Standard Mail, observations of higher than expected First-Class Mail volume, if caused exclusively by better than anticipated response to the after rates discounts, would be accompanied by observed shortfalls in Standard Mail volumes. On the other hand, if both First-Class and Standard Mail volumes were

substantially exceeding forecasts, the natural conclusion would be that exogenous (before rates) factors were behind the surge in volume, and higher threshold levels would therefore be warranted.

To return to the example, if First-Class Mail volumes exceeded the forecast by 23 percent, and Standard Mail volumes also exceeded forecast by a comparable amount, then it would be difficult to believe that the higher First-Class volumes were the result of a hugely successful response to the discounts shifting larger portions of Standard Mail to First-Class Mail. Alternatively, if the Standard Mail volume under the same circumstances were well below the forecast, it would be much more difficult to reject the hypothesis that the additional First-Class Mail volumes were, in fact, shifting from Standard Mail in exactly the fashion that the NSA was intended to encourage. While the logic of this mechanism might suggest that any unexpected increase in Standard Mail volumes could potentially negate the inference that unanticipated First-Class Mail increases were exclusively the result of the incentives performing as desired to convert more pieces from First-Class to Standard, the parties negotiated a five percent cushion on the Standard Mail portion of the trigger so that upward threshold adjustments would occur only when there was truly unambiguous evidence of a rising tide lifting all boats.

The third customer-specific term is a negotiated cap. The HSBC NSA stipulates a negotiated cap of $9 million over the life of the NSA. This cap is the maximum amount of discounts that HSBC can receive from the Postal Service over the life of the agreement. The Postal Service accepted the cap negotiated with HSBC, and agreed that it reinforces the goals of the NSA approach.

The Postal Service evaluated the proposed cap using Commission's logic of the Docket MC2004-4 to establish its position while in negotiations with HSBC. The Postal Service used a 100 percent pass through of the ACS cost savings of $8.1 million plus the competitive adjustment given in Docket MC2004-04 of 10.09 percent. This equals $8.9 million ($8.1 million + $.8 million).

While the Postal Service accepts the cap in the instant proceeding, and the cap is the result of arms-length negotiations, the Postal Service continues to believe that caps for any purpose will not necessarily benefit either the customer or the Postal Service. This is especially so in this case, where the Postal Service mitigated its risk by negotiating an annual adjustment mechanism to the threshold and specified out-year thresholds. Regarding the Capital One type of "stop-loss" cap, it is unlikely the Postal Service's exposure from misestimating could exceed the expected ACS savings from the HSBC NSA. Therefore, imposition of a "stop-loss" cap, in the context of the HSBC NSA, is not necessary to mitigate this specific form of risk.

Finally, the DMCS provisions proposed in this case include yet another customer-specific term, an implementation date threshold adjustment mechanism. The HSBC forecasts provided by witness Harvey for Years 1, 2, and 3 of the agreement are, in fact, forecasts for calendar years 2005, 2006, and 2007, and the discount volume thresholds for Years 1, 2, and 3 were negotiated with those specific volume forecasts in mind. As the actual implementation date advances into calendar year 2005, the volume thresholds applied in Year 1 of the agreement (i.e., the first 12-month period following implementation) should reflect the fact that an increasing share of Year 1 will actually fall within calendar 2006. In order to preserve the original intent of the parties, the

proposed DMCS provision increases the threshold levels on a pro rata basis for each month that implementation lags the start of calendar year 2005. Specifically, the difference between the thresholds for Years 1 and 2 is pro-rated monthly, so that if, for example, implementation occurs halfway through 2005 (i.e., in July of 2005), then the Year 1 initial threshold would increase by one-half of the difference between the negotiated Year 1 and Year 2 thresholds. Similarly, if implementation occurs after 8 months have transpired (i.e., in September 2005), then the Year 1 threshold would increase by two-thirds (8/12) of the difference. For Year 2, a corresponding adjustment would be made by applying the same proportional factor (i.e., one-half if implementation is in July, two-thirds if in September, etc.) to the difference between the Year 2 and Year 3 thresholds, and adding that amount to the Year 2 threshold. For Year 3, the threshold would be increased by the same absolute volume amount as the Year 2 threshold adjustment. For purposes of evaluating potential annual threshold adjustments at the end of Years 1 and 2, as described above, the before-rates volume forecasts for Years 1 and 2 would also be increased by applying the same proportional factor to, respectively, the differences between witness Harvey's before-rates forecasts for Years 1 and 2, and for Years 2 and 3.

V. Financial Impacts

A. Value Factors/Elements

As with the Capital One NSA, the HSBC NSA has three factors affecting the value: ACS cost savings, new volume contribution, and discount exposure (leakage). The first value driver, ACS cost savings, are the savings that accrue to the Postal Service from eliminating the physical return of First-Class Mail marketing pieces with an

electronic return notice. Rather than having its undeliverable-as-addressed (UAA) marketing pieces physically returned, HSBC has agreed to receive most address correction information electronically through the computerized ACS system. This is the same ACS system that was described more fully in the testimony of witness Wilson (USPS-T4) in Docket No. MC2002-2. (MC2002-2) USPS-T-4 at 3-4. Conversion to ACS would save the Postal Service the costs of returning UAA mail through the mail stream to the location where HSBC would have processed return mail.

The second value driver for the Postal Service is the volume contribution from any new volume generated by the NSA. This contribution is calculated using the following inputs: per piece contribution of First-Class Mail, per piece contribution of Standard Mail, and the percent of new First-Class marketing mail converted from Standard to First-Class.

As HSBC Witness Harvey explains, the price incentives in the NSA are expected to produce a First-Class Mail volume response of 16 million pieces in Year 1, and 20 million pieces in each of Year 2 and Year 3. The new contribution must offset any substitution leakage that would result from the loss of contribution from Standard Mail pieces which might be converted to incremental First-Class Mail marketing pieces. To be conservative, HSBC has estimated that 100 percent of incremental volume would be converted from Standard Mail. HSBC-T-1 at 9. Both the Postal Service and HSBC believe that the incremental volumes could very well exceed the forecast. *Id.* (See Part C., Conservatism of Assumptions, below.)

The final value driver is the expected discount exposure. The discount exposure lowers the value of the NSA and is the result of price incentives applied to any volume

that would have occurred without a price incentive. As described by witness Eakin, setting a threshold below forecast volume is economically efficient because it reduces the mailer's marginal price of First-Class Mail relative to other forms of solicitation, and reduces the gap between marginal price and marginal cost of the mailer's First-Class Mail. (MC2002-2,USPS-RT-2 at 4-5, Tr. 10/2069-70).

I estimate the value to the Postal Service of the HSBC agreement, when considering all three value drivers, over the three years of the NSA, as follows:

ACS Cost savings:	$6.6 million
Increased contribution:	$4.1 million
Discount exposure:	($4.4) million

The agreement therefore would result in a net benefit to the Postal Service of $6.3 million over the life of the NSA. A detailed analysis of the financial impact is provided in Appendix A.

B. Financial Model

I believe that the analysis provided in the valuation model of the HSBC NSA complies with the guidelines established by the Commission in Rule 193(e). The model follows witness Crum's methodology in Docket No. MC2002-2, except in instances where a change allows it to conform more closely to the requirements of Rule 193(e). The features of the model are described below; the model is in Appendix A and any changes are discussed in Appendix B.

In order to comply with Rule 193(e)(2), the Postal Service and HSBC have provided more data than in Docket No. MC2002-2 in order to present a more

representative estimate of the cost and volume effects of the NSA in Years 2 and 3 of the agreement. See Appendix B at 2-3. In witness Harvey's testimony, HSBC has provided estimates of After Rate mail volume forecasts in Years 2 and 3 of the agreement, which are minimum forecasts, as Mr. Harvey notes. HSBC-T-1 at 7-8.

In Appendix A, a contingency factor of 3 percent has been applied to all per piece cost calculations, including First-Class Mail, Standard Mail, and the physical and electronic costs of ACS. This adjustment is needed to gain certification from the Chief Financial Office of the Postal Service.

In addition, as described in Appendix B, the Postal Service applies a 4 percent annual inflationary cost adjustment factor to estimate unit costs in the each year of the agreement and to account for cost increases since litigation of the Capital One NSA agreement. This cost adjustment factor will provide a better estimate of the value of the NSA in the out-years of the agreement as requested by the Commission.[1] In other respects, the cost assumptions for the HSBC mail pieces are based on Docket No. MC2002-2.[2]

C. Conservatism of Estimated Value

The After Rates (AR) forecast provided by HSBC is, in the opinion of the Postal Service, a conservative estimate of the potential volume response to the price incentives.

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[1] There remains a possibility of a rate increase during the term of the agreement; such an increase has not been accounted for in the revenue calculations. To the extent that revenues in the out-years have been undercounted, greater credence is lent to the conservatism of any assumption.

[2] Just as in the Capital One case, the Postal Service is not providing estimates of forwarded mail.

In fact, there are reasons why these forecasts would generally tend toward conservatism. Non-linear pricing of First-Class Mail is relatively new to the Postal Service. Consequently, postal customers have no direct experience in planning postage expenditures, nor in adjusting budgets when – as may happen if HSBC reaches its initial declining block threshold – the cost of customer acquisition declines. If customers use traditional modeling techniques out of necessity, forecast volume effects are likely to understate the result of sudden and substantial price reductions. Moreover, banks work in a highly regulated and extensively analyzed industry, where public pronouncements can have significant consequences. This is also likely to act as a check against unwarranted optimism in projecting future outcomes.

One of the difficulties that arise in forecasting volumes in Years 1, 2, and 3 of the agreement is that, in complex mailing environments, postage is not the only variable that determines future mailing strategies. The customer and the Postal Service believe – and universally accepted principles of economics confirm – that, keeping all other business variables constant, lower postage costs will provide an incentive for greater mail volumes. Yet, most companies do not currently forecast the impact of declining postage rates, and it is difficult to predict the full impact on mail volumes. Thus, the point estimates provided are conservative and the Postal Service anticipates that the volume response could very well be higher.

VI. COMPETITIVE IMPACT ANALYSIS

The impact of the Capital One NSA on the competitors of the contracting parties was discussed and evaluated extensively in the baseline proceeding. (MC 2002-2, JCP-T-1 at 11-12 and USPS-RT-2 at 11-14.) In the end, the Commission concluded

that the impact on competition would be minor. In this regard, the Commission found it significant that no competitors of Capital One opposed the NSA.

I estimate that the impact on competition of the HSBC NSA – which is functionally equivalent to the Capital One NSA – should be even less, since HSBC and Capital One are similarly situated, *i.e.,* direct competitors. Further, the pool of competitors which may be disadvantaged because they do not have an NSA decreases as the number of functionally equivalent agreements increase. For functionally equivalent agreements of direct competitors of the baseline agreement, any industry competitive impacts have been addressed in the baseline filing. More importantly, approving functionally equivalent NSAs provides competitors of Capital One the same incentives to grow their mail volumes. This is not to suggest that postage prices are the sole - or even the primary - dimension along which all competitors in an industry may compete. Indeed, there may be circumstances when it would be impracticable or otherwise inappropriate to provide NSAs to all competitors within an industry.

VII. NEGOTIATED CAP

A "stop-loss provision" or discount cap of $40 million over three years was incorporated in the rate and classification changes implementing the Capital One NSA. This was not a condition that was negotiated between the Postal Service and Capital One, but was added by the Commission (PRC Op., MC2002-2, ¶ 5061).

The Commission explained that it instituted the stop-loss provision because of the variability inherent in the volume history of Capital One. The concern over "discount leakage" exceeding cost savings thus influenced the decision to limit the total value of incentives Capital One could earn (PRC Op., MC2002-2, ¶ 8024). In setting the cap,

the Commission found that there would be no impact on new volume contribution because the thresholds were above the revised forecast. However, a cap based on either cost savings or exposure (leakage) unnecessarily hinders the ultimate objective of utilizing NSAs as a tool to increase net contribution. Basing the "stop-loss provision" solely on cost savings would tend to limit participation in the NSA process to only large volume mailers who can offer significant cost savings opportunities. This would place customers who do not impose added costs on the Postal Service at a disadvantage.

More importantly, a stop-loss provision similar to Capital One's could foreclose the potential contribution from increased volume. It also would impose a competitive disadvantage on HSBC, because its potential cost savings are not nearly as large as the potential cost savings for Capital One, which is a larger originator of First-Class Mail marketing solicitations than HSBC.

Accordingly, a cap could actually cause harm because it would limit the upside potential of the NSA. As discussed previously, the HSBC forecasts are conservative, and it is quite possible that the incremental volume may be higher than predicted. A "stop-loss" cap hinders this possibility. Nevertheless, according to the recent Bank One Corporation decision, a cap is recommended by the Commission to ". . . preserve the win-win situations . . ." and ". . . holds significance in the review of this [MC2004-3] request under the functional equivalency rules, with the Capital One Negotiated Service Agreement as the baseline" (PRC Op., MC2004-3 ¶ 1010 -1011). To lessen the degree of complexity in determining the functional equivalency of HSBC, both parties have negotiated a cap to keep within the expedited procedures and thereby reducing the litigation costs to HSBC and the Postal Service.

VIII. PROPOSED PRICES ARE CONSISTENT WITH THE CRITERIA OF THE ACT

Title 39, Section 3623 requires that the Commission evaluate proposed changes in the classification schedule in accordance with the policies of the Title and the following factors:

1. the establishment and maintenance of a fair and equitable classification system for all mail;
2. the relative value to the people of the kinds of mail matter entered into the postal system and the desirability and justification for special classifications and services of mail;
3. the importance of providing classifications with extremely high degrees of reliability and speed of delivery;
4. the importance of providing classifications which do not require an extremely high degree of reliability and speed of delivery;
5. the desirability of special classifications from the point of view of both the user and of the Postal Service; and
6. such other factors as the Commission may deem appropriate.

Section 3622(b) requires that postal rates and fees reflect the policies of the Postal Reorganization Act, and accord with the following factors:

1. the establishment and maintenance of a fair and equitable schedule;
2. the value of the mail service actually provided each class or type of mail service to both the sender and the recipient, including but not limited to, the collection, mode of transportation, and priority of delivery;
3. the requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributable to that class or type plus that portion of all other costs of the Postal Service reasonably assignable to such class or type;
4. the effect of rate increases upon the general public, business mail users, and enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters;
5. the available alternative means of sending and receiving letters and other mail matter at reasonable costs;
6. the degree of preparation of mail for delivery into the postal system performed by the mailer and its effect upon reducing costs to the Postal Service;
7. simplicity of structure for the entire schedule and simple, identifiable relationships between the rates or fees charged the various classes of mail for postal services;
8. the educational, cultural, scientific, and informational value to the recipient of mail matter; and
9. such other factors as the Commission deems appropriate.

The arguments presented by witness Plunkett in the Capital One NSA are also applicable to the HSBC NSA:

> ...the Postal Service believes that by negotiating directly with individual customers, it may be possible, through negotiated service agreements such as the one submitted here, to more accurately present prices that represent the value that the user places on the service being provided (pricing criterion 2) for mail classifications that are desirable to the mailer and the Postal Service (classification criterion 5). In this case, the Postal Service has directly negotiated with the sender of the mail to arrive at classifications and prices that the Postal Service considers to be fair and equitable (classification criterion 1 and pricing criterion 1). As indicated in the testimony of witness Crum, there can be no doubt that the prices presented in this case will cover the costs of providing the service (price criterion 3). In fact, the address improvement steps that Capital One has agreed to will serve to lower the costs currently borne by other customers (pricing criterion 6). For this reason, the classifications and prices presented in this agreement confer beneficial effects on the general public and other ratepayers (classification criterion 1 and pricing criterion 1). The proposed rates do not have an adverse impact on the rates paid by the general public, or other business mail users (pricing criterion 4). The proposed declining block rate structure is relatively simple and maintains a transparent, identifiable relationship between volume levels and applicable rates and fees (pricing criterion 7). (MC2002-2, USPS-T-2, page 9, line 36 – page 10, line 15).

I believe that these pricing and policy issues were comprehensively addressed in the Capital One NSA docket, and that the logic of *functional equivalence* enables reliance on the findings in that case. In this instance, the close comparability of the structure and elements of the HSBC and Capital One NSAs, the similarity of their situations as mailers, and their status as competitors, warrant full reliance on the Commission's findings to justify recommending the proposed changes based on the HSBC NSA. Further, the customer-specific rates offered to HSBC more than cover the costs associated with HSBC's mail, thus meeting pricing criterion 1, which concerns

fairness and equity, as well as pricing criterion 3, which addresses the requirement to cover all costs.

IX. SUMMARY AND CONCLUSIONS

This testimony has described and discussed the similarities and differences between the HSBC NSA and the Capital One NSA. The HSBC NSA has the same substantive functional elements of the Capital One NSA, comparable benefits, other material terms and conditions that were included in the Capital One NSA, and some additional provisions. The additional provisions in the HSBC NSA reflect the differences between the companies that are inherent in their status as individual mailers. HSBC is functionally equivalent to Capital One, and the fact that it is a direct competitor makes expeditious treatment of this filing under the Commission's specialized procedures especially important.

Accordingly, I conclude that the HSBC NSA meets the standards for functional equivalency. The financial model developed to support the HSBC NSA is based on the model submitted in Docket MC2002-2, with analytical enhancements as recommended by the Commission in Rule 193(e). The HSBC NSA also meets the terms and conditions that must be included for an agreement to be considered comparable to Capital One, as codified in DMM G911.

Finally, based on the Commission's findings and conclusions in its review of the baseline NSA, the HSBC NSA meets the criteria outlined for classifications in Title 39, Section 3623 of the Postal Reorganization Act as well as the criteria for postal rates and fees as outlined in Section 3622(b) of the Act.

For these reasons, I submit that the Commission should determine that the HSBC NSA is functionally equivalent to the Capital One baseline NSA and, in light of the expected benefits, should recommend the implementation of the HSBC NSA, as proposed by the parties.

DATA AND APPENDICES

Appendix A:	**FINANCIAL MODEL**
Appendix B:	**EXPLANATION OF FINANCIAL MODEL**
Appendix C:	**HSBC FINANCIAL SERVICES NSA PROPOSED DATA COLLECTION PLAN**

Revised: March 11, 2005

HSBC North America Holdings Inc. Model

Negotiated Service Agreement

Appendix A, page 1

	Year 1	Year 2	Year 3
Return Forecast			
(1) Operational Mail (Ops)	0.3%	0.3%	0.3%
(2) Marketing Mail (Mktg)	4.75%	4.75%	4.75%
(3) USPS FCM average return rates	1.23%	1.23%	1.23%
Unit cost assumptions			
(4) Inflation cost adjustment factor	4.0%	4.0%	4.0%
(5) Manual Letter Returns Unit Cost	$ 0.57	$ 0.60	$ 0.62
(6) Electronic Letter Returns Unit Cost	$ 0.36	$ 0.37	$ 0.39
(7) Address Change Service (ACS) Success Rate	85.0%	85.0%	85.0%
(8) Percent of new marketing mail switched from Standard Mail (SM) or Conversion Rate	100.0%	100.0%	100.0%
(9) Contingency Factor	1.03		

(1) Harvey (HSBC-T-1)
(2) Harvey (HSBC-T-1)
(3) USPS-LR-1/MC2002-2
(4) Dauer (USPS-T-1)
(5) USPS-LR-1/MC2002-2 * (1 + (4)) * (1 + (4))
(6) USPS-LR-1/MC2002-2 * (1 + (4)) * (1 + (4))
(7) USPS witness Wilson, T4/MC2002-2
(8) Harvey (HSBC-T-1)
(9) USPS-LR-1/MC2002-2

HSBC North America Holdings Inc. Model

Negotiated Service Agreement
Appendix A, page 2

	2002	2003	2004	Year 1	Year 2	Year 3
(1) **First-Class Mail Volume calculations**						
Before Rates						
Operational mail	407,693,861	409,784,484	439,597,836	483,021,271	518,407,521	556,469,938
Marketing mail letter	107,741,060	89,141,274	95,685,915	158,232,348	245,191,188	299,268,268
Total	**515,434,921**	**498,925,758**	**535,283,751**	**641,253,619**	**763,598,709**	**855,738,206**
After Rates						
Operational mail	407,693,861	409,784,484	439,597,836	483,021,271	518,407,521	556,469,938
Marketing mail letter	107,741,060	89,141,274	95,685,915	174,232,348	265,191,188	319,268,268
Total	**515,434,921**	**498,925,758**	**535,283,751**	**657,253,619**	**783,598,709**	**875,738,206**

(1) Harvey (HSBC-T-1)

HSBC North America Holdings Inc. Model Negotiated Service Agreement Appendix A, page 3	(1) Volume	(2) Rates	(3) Revenue
Rate Category			
Single-Piece Letters			
First Ounces, except QBRM	-	0.370	$ -
Qualified Business Reply Mail	-	0.340	-
Additional Ounces	-	0.230	-
Nonmachinable Pieces	-	0.120	-
Single-Piece revenue			-
Revenue Adjustment Factor (a)			1.000
(4) Total Single-Piece Postage Revenue			-
Nonautomated Presorted Letters			
First Ounce	9,805,861	0.352	3,451,663
Additional Ounces	-	0.225	-
Nonmachinable Pieces	-	0.055	-
Heavy Piece Deduction	-	(0.041)	-
Nonautomated Presorted Revenue			3,451,663
Revenue Adjustment Factor (a)			1.000
(5) Total Nonautomated Presorted Letters Revenue			3,451,663
Automation Presort Letters			
Mixed AADC Letters	31,387,770	0.309	9,698,821
AADC Letters	41,768,164	0.301	12,572,217
3-Digit Letters	264,042,110	0.292	77,100,296
5-Digit Letters	78,242,286	0.278	21,751,356
Additional Ounces	-	0.225	-
Heavy Piece Deduction	-	(0.041)	-
Automation Presort Letter Revenue			121,122,690
Revenue Adjustment Factor (a)			1.000
(6) Total Automation Presort Letters Revenue			121,122,690
Automation Carrier Route Letters			
First Ounce	14,351,645	0.275	3,946,702
Additional Ounces	-	0.225	-
Heavy Piece Deduction	-	(0.041)	-
Automation Carrier Route Revenue			3,946,702
Revenue Adjustment Factor (a)			1.000
(7) Automation Carrier Route Letters Revenue			3,946,702
(8) Total Company Letters Subclass			$ 128,521,055
Total pieces			439,597,836
(9) **Revenue per piece**			**0.292**

(a) Revenue Adjustment Factor not required because customer specific revenue is presented
(1) CBCIS 2004 HSBC Volume Data
(2) Rate Schedule
(3) (1) * (2)
(4) Single Piece Revenue * Revenue Adjustment Factor
(5) Nonautomated Presorted Revenue * Revenue Adjustment Factor
(6) Automation Presort Letter Revenue * Revenue Adjustment Factor
(7) Automation Carrier Route Revenue * Revenue Adjustment Factor
(8) (4) + (5) + (6) + (7)
(9) (8) / Total pieces

HSBC North America Holdings Inc. Model

Negotiated Service Agreement
Appendix A, page 4

	(1) Volume	(2) Rates	(3) Revenue
Rate Category			
Single-Piece Letters			
First Ounces, except QBRM	-	0.370	$ -
Qualified Business Reply Mail	-	0.340	-
Additional Ounces	-	0.230	-
Nonmachinable Pieces	-	0.120	-
Single-Piece revenue			-
Revenue Adjustment Factor (a)			1.000
(4) Total Single-Piece Postage Revenue			-
Nonautomated Presorted Letters			
First Ounce	61,007	0.352	21,474
Additional Ounces	-	0.225	-
Nonmachinable Pieces	-	0.055	-
Heavy Piece Deduction	-	(0.041)	-
Nonautomated Presorted Revenue			21,474
Revenue Adjustment Factor (a)			1.000
(5) Total Nonautomated Presorted Letters Revenue			21,474
Automation Presort Letters			
Mixed AADC Letters	11,944,126	0.309	3,690,735
AADC Letters	18,498,424	0.301	5,568,026
3-Digit Letters	59,695,294	0.292	17,431,026
5-Digit Letters	5,313,665	0.278	1,477,199
Additional Ounces	-	0.225	-
Heavy Piece Deduction	-	(0.041)	-
Automation Presort Letter Revenue			28,166,985
Revenue Adjustment Factor (a)			1.000
(6) Total Automation Presort Letters Revenue			28,166,985
Automation Carrier Route Letters			
First Ounce	173,399	0.275	47,685
Additional Ounces	-	0.225	-
Heavy Piece Deduction	-	(0.041)	-
Automation Carrier Route Revenue			47,685
Revenue Adjustment Factor (a)			1.000
(7) Automation Carrier Route Letters Revenue			47,685
(8) Total Company Letters Subclass			$ 28,236,144
Total pieces			95,685,915
(9) ***Revenue per piece***			**0.295**

(a) Revenue Adjustment Factor not required because customer specific revenue is presented
(1) CBCIS 2004 HSBC Volume Data
(2) Rate Schedule
(3) (1) * (2)
(4) Single Piece Revenue * Revenue Adjustment Factor
(5) Nonautomated Presorted Revenue * Revenue Adjustment Factor
(6) Automation Presort Letter Revenue * Revenue Adjustment Factor
(7) Automation Carrier Route Revenue * Revenue Adjustment Factor
(8) (4) + (5) + (6) + (7)
(9) (8) / Total pieces

HSBC North America Holdings Inc. Model
Negotiated Service Agreement
Appendix A, page 5

	DOCKET NO. R2001-1 PRC FIGURES - NATIONWIDE MAIL MIX								HSBC MAIL MIX						
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)
Rate Category	TYBR 2003 Total Unit Cost (Dollars)	TYBR 2003 Mail Proc Unit Cost (Dollars)	TYBR 2003 Delivery Unit Cost (Dollars)	TYBR 2003 Other Unit Cost (Dollars)	TYBR 2003 Total Unit Cost (Dollars)	FY 2005 Total Unit Cost Dollars	BY 2000 Mail Volume (Pieces)	FY 2003 Mail Volume (Pieces)	FY 2003 Mail Volume (Percent)	TY 2005 Total Unit Cost (Dollars)	FY 2004 Mail Volume (Pieces)	FY 2004 Mail Volume (Percent)	Current Returns Adjustment Unit Cost (Dollars)	Current w/Rets Adj Total Unit Cost (Dollars)	After Rates Returns Adjustment Unit Cost (Dollars)	After Rates w/Rets Adj Total Unit Cost (Dollars)
FIRST-CLASS MAIL LETTERS																
Nonautomation Presort Letters		0.183	0.063	0.018	0.244	0.264	3,748,977,000	2,573,332,488	5.8%	0.264	9,805,861	2.2%				
Automation Presort Letters																
Automation Mixed AADC		0.055	0.045	0.018	0.118	0.128	2,504,846,824	2,620,696,002	6.1%	0.128	31,387,770	7.1%				
Automation AADC		0.046	0.044	0.018	0.107	0.116	2,660,856,176	2,636,650,800	5.7%	0.116	41,788,164	9.5%				
Automation 3-Digit		0.042	0.043	0.018	0.104	0.112	21,832,339,000	22,571,247,888	48.8%	0.112	264,042,110	60.1%				
Automation 5-Digit		0.032	0.041	0.018	0.091	0.098	12,720,447,000	14,911,024,110	32.1%	0.098	78,242,266	17.8%				
Automation Carrier Route		0.021	0.064	0.018	0.103	0.111	1,075,333,000	802,292,828	1.7%	0.111	14,351,645	3.3%				
WEIGHTED AVERAGE / TOTAL	**$0.116**	**0.060**	**0.045**	**0.018**	**0.109**	**0.118**	**44,562,599,000**	**46,415,243,896**	**100.0%**	**0.114**	**439,887,836**	**100.0%**	**$ (0.0053)**	**0.108** (17)	**$ (0.0053)**	**0.108** (18)
														Total Unit Cost Estimates, Including Contingency =		0.112		0.112

(1) Docket No. R2001-1, PRC LR-2, Volume 4, "TYBR", page 3
(2) Docket No. R2001-1, PRC LR-4, "FCLETPRCFA.XLS", page 1
(3) Docket No. R2001-1, PRC LR-7, Page 2
(4) MC2002-2/USPS-T-3, Attachment A, pg. 2
(5) (2) + (3) + (4)
(6) (5) * (1 + inflation cost adjustment factor) * (1 + inflation cost adjustment factor)
(7) Docket No. R2001, PRC, LR-4, FCM base year volumes from FCM letter model.
(8) Revenue, Pieces, and Weight (RPW) Report.
(9) (8) / [Sum (8)]
(10) Line item (6), Weighted Average weighted by percentages in (12).
(11) CBCIS 2004 HSBC Volume Data
(12) (11) / [Sum (11)]
(13) (Manual Letter Returns Unit Cost * After Rates Statement Mail) * (Statement Mail Return Forecast - USPS FCM Avg. Return Rate) / After Rates Statement Mail
(14) (10) + (13)
(15) (Manual Letter Returns Unit Cost * After Rates Statement Mail) * (Statement Mail Return Forecast - USPS FCM Avg. Return Rate) / After Rates Statement Mail
(16) (10) + (15)
(17) (14) * Contingency Factor (Assumptions)
(18) (16) * Contingency Factor (Assumptions)

HSBC North America Holdings Inc. Model
Negotiated Service Agreement
Appendix A, page 6

	DOCKET NO. R2001-1 PRC FIGURES - NATIONWIDE MAIL MIX									HSBC MAIL MIX						
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)
Rate Category	TYBR 2003 Total Unit Cost (Dollars)	TYBR 2003 Mail Proc Unit Cost (Dollars)	TYBR 2003 Delivery Unit Cost (Dollars)	TYBR 2003 Other Unit Cost (Dollars)	TYBR 2003 Total Unit Cost (Dollars)	FY 2005 Total Unit Cost Dollars	BY 2000 Mail Volume (Pieces)	FY 2003 Mail Volume (Pieces)	FY 2003 Mail Volume (Percent)	TY 2005 Total Unit Cost (Dollars)	FY 2004 Mail Volume (Pieces)	FY 2004 Mail Volume (Percent)	Current Returns Adjustment Unit Cost (Dollars)	Current w/Rets Adj Total Unit Cost (Dollars)	After Rates Returns Adjustment Unit Cost (Dollars)	After Rates w/Rets Adj Total Unit Cost (Dollars)
FIRST-CLASS MAIL LETTERS																
Nonautomation Presort Letters		0.163	0.063	0.018	0.244	0.264	3,748,977,000	2,673,332,468	5.8%	0.264	61,007	0.1%				
Automation Presort Letters																
Automation Mixed AADC		0.055	0.045	0.018	0.118	0.128	2,504,846,824	2,820,696,002	6.1%	0.128	11,944,126	12.5%				
Automation AADC		0.048	0.044	0.018	0.107	0.116	2,660,656,176	2,636,650,800	5.7%	0.116	18,498,424	19.3%				
Automation 3-Digit		0.042	0.043	0.018	0.104	0.112	21,832,339,000	22,571,247,888	48.6%	0.112	59,895,294	62.4%				
Automation 5-Digit		0.032	0.041	0.018	0.091	0.098	12,720,447,000	14,911,024,110	32.1%	0.098	5,313,665	5.6%				
Automation Carrier Route		0.021	0.064	0.018	0.103	0.111	1,075,333,000	802,292,628	1.7%	0.111	173,399	0.2%				
WEIGHTED AVERAGE / TOTAL	**$0.115**	**0.050**	**0.045**	**0.018**	**0.109**	**0.118**	**44,562,599,000**	**46,415,243,896**	**100.0%**	**0.114**	**95,885,915**	**100.0%**	**0.0202**	**0.134**	**0.0114**	**0.125**
														(17)		(18)
										Total Unit Cost Estimates, Including Contingency =				0.138		0.129

(1) Docket No. R2001-1, PRC LR-2, Volume 4, "TYBR", page 3.
(2) Docket No. R2001-1, PRC LR-4, "FCLETPRCFA.XLS".
(3) Docket No. R2001-1, PRC LR-7, Page 2 .
(4) (1) - Weighted Average(2) - Weighted Average(3)
(5) (2) + (3) + (4)
(6) (5) * (1 + inflation cost adjustment factor) * (1 + inflation cost adjustment factor)
(7) Docket No. R2001, PRC, LR-4, FCM base year volumes from FCM letter model.
(8) Revenue, Pieces, and Weight (RPW) Report.
(9) (8) / [Sum (8)]
(10) Line Item (6), Weighted Average weighted by percentages in (12).
(11) CBCIS 2004 HSBC Volume Data
(12) (11) / [Sum (11)]
(13) (Manual Letter Returns Unit Cost * After Rates Statement Mail) * (Statement Mail Return Forecast - USPS FCM Avg. Return Rate) / After Rates Statement Mail
(14) (10) + (13)
(15) ((ACS Success Rate * Electronic Letter Returns Unit Cost + (1 - ACS Success Rate) * Manual Letter Returns Unit Cost) * After Rates Statement Mail * (Statement Mail Return Forecast - USPS FCM Avg. Return Rate))) / After Rates Statement Mail - USPS FCM Avg. Return Rate * (Manual Letter Returns Unit Cost - Electronics Letter Returns Unit Cost) * ACS Success Rate
(16) (10) + (15)
(17) (14) * Contingency Factor (Assumptions)
(18) (16) * Contingency Factor (Assumptions)

Agreement Structure

Year 1			Year 2			Year 3		
Threshold		Discount	Threshold		Discount	Threshold		Discount
615,000,000	655,000,000	$ 0.025	725,000,000	765,000,000	$ 0.025	810,000,000	850,000,000	$ 0.025
655,000,000	675,000,000	$ 0.030	765,000,000	785,000,000	$ 0.030	850,000,000	870,000,000	$ 0.030
675,000,000	695,000,000	$ 0.035	785,000,000	805,000,000	$ 0.035	870,000,000	890,000,000	$ 0.035
695,000,000	715,000,000	$ 0.040	805,000,000	825,000,000	$ 0.040	890,000,000	910,000,000	$ 0.040
715,000,000	735,000,000	$ 0.045	825,000,000	845,000,000	$ 0.045	910,000,000	930,000,000	$ 0.045
735,000,000		$ 0.050	845,000,000		$ 0.050	930,000,000		$ 0.050

Discount on volume above threshold

(1)	Before Rates Forecast	641,253,619	763,598,709	855,738,206
(2)	After Rates Forecast	657,253,619	783,598,709	875,738,206
	Discount in first tier	$ 1,000,000	$ 1,000,000	$ 1,000,000
	Discount in second tier	$ 67,609	$ 557,961	$ 600,000
	Discount in third tier	$ -	$ -	$ 200,837
	Discount in fourth tier	$ -	$ -	$ -
	Discount in fifth tier	$ -	$ -	$ -
	Discount in sixth tier	$ -	$ -	$ -
(3)	**Discount Earned**	**$ 1,067,609**	**$ 1,557,961**	**$ 1,800,837**

Exposure on volume above threshold

(4)	Threshold	615,000,000	725,000,000	810,000,000
(5)	Before Rates Forecast	641,253,619	763,598,709	855,738,206
(6)	Exposed Pieces	26,253,619	38,598,709	45,738,206
(7)	After Rates Forecast	657,253,619	783,598,709	875,738,206
	Exposure in first tier	$ 656,340	$ 964,968	$ 1,000,000
	Exposure in second tier	$ -	$ -	$ 172,146
	Exposure in third tier	$ -	$ -	$ -
	Exposure in fourth tier	$ -	$ -	$ -
	Discount in fifth tier	$ -	$ -	$ -
	Discount in sixth tier	$ -	$ -	$ -
(8)	**Total Exposure**	**$ 656,340**	**$ 964,968**	**$ 1,172,146**

(1) Before Rates Total Volume (Volume calcs)
(2) After Rates Total Volume (Volume calcs)
(3) Sum of discounts earned in first tier to sixth tier
(4) Agreement Structure Beginning Threshold
(5) (1)
(6) Before rates - Threshold: The number of total pieces on which Exposure occurs
(7) (2)
(8) Sum of Exposure in first tier to sixth tier

HSBC North America Holdings Inc. Model

Negotiated Service Agreement

Appendix A, page 8

		Year 1	Year 2	Year 3
Return Costs				
	UAA Rate			
(1)	Statement mail	0.3%	0.3%	0.3%
(2)	Marketing mail	4.75%	4.75%	4.75%
Before Rates Forecast				
(3)	Statement mail	483,021,271	518,407,521	556,469,938
(4)	Marketing mail	158,232,348	245,191,188	299,268,268
Return Forecast				
(5)	Statement mail	1,449,064	1,555,223	1,669,410
(6)	Marketing mail	7,516,037	11,646,581	14,215,243
Return Costs				
(7)	Statement mail	$ 855,593	$ 955,005	$ 1,066,128
(8)	Marketing mail	$ 4,437,809	$ 7,151,738	$ 9,078,221
(9)	Total	$ 5,293,403	$ 8,106,743	$ 10,144,349
After Rates Return Costs				
(10)	Statement mail	$ 855,593	$ 955,005	$ 1,066,128
(11)	Marketing mail	$ 3,014,361	$ 4,857,784	$ 6,166,339
(12)	Total	$ 3,869,954	$ 5,812,789	$ 7,232,467
(13) Return Cost Savings		**$ 1,423,448**	**$ 2,293,954**	**$ 2,911,882**

(1) Harvey (HSBC-T-1)
(2) Harvey (HSBC-T-1)
(3) Harvey (HSBC-T-1)
(4) Harvey (HSBC-T-1)
(5) (1) * (3)
(6) (2) * (4)
(7) (5) * (Manual Letter Returns Unit Cost * Contingency Factor) (Assumptions)
(8) (6) * (Manual Letter Returns Unit Cost * Contingency Factor) (Assumptions)
(9) (7) + (8)
(10) (5) * (Manual Letter Returns Unit Cost * Contingency Factor) (Assumptions)
(11) ((6) * ACS Success Rate * Electronic Letter Returns Unit Cost * Contingency Factor) +((1 - ACS Success Rate) * Manual Letter Returns Unit Cost * (6) * Contingency Factor)
(12) (10) + (11)
(13) (9) - (12)

HSBC North America Holdings Inc. Model

Negotiated Service Agreement
Appendix A, page 9

(1) Standard Mail Regular Revenue per piece

Mail Category	Revenue per piece	Volume	Weighted Avg.
Mixed AADC Auto	$ 0.214	7,219,345	1,543,496
AADC Auto	$ 0.206	20,311,073	4,177,988
3-Digit Auto	$ 0.188	182,672,355	34,305,868
5-Digit Auto	$ 0.169	101,052,532	17,057,667
Basic Nonauto	$ 0.253	1,197,363	302,813
3/5 Digit Nonauto	$ 0.227	469,903	106,621
Total Volume		312,922,571	57,494,453
Revenue per piece			**$ 0.184**

(2) Standard Mail ECR Revenue per piece

Mail Category	Revenue per piece	Volume	Weighted Avg.
Basic Nonauto Letters	$ 0.172	20,947	3,607
Basic Auto Letters	$ 0.149	12,494,212	1,857,889
Saturation Letters	$ 0.126	-	-
Total Volume		12,515,159	1,861,496
Revenue per piece			**$ 0.149**

(3) Average Revenue per piece **$ 0.182**

(1) 2004 Standard Mail Regular Billing Determinants
(2) 2004 Standard Mail ECR Billing Determinants
(3) *(Standard Mail Regular Revenue + Standard Mail ECR Revenue) /*
(Standard Mail Regular Total Volume + Standard Mail ECR Total Volume)

HSBC North America Holdings Inc. Model
Negotiated Service Agreement
Appendix A, page 10

Standard Regular Unit Cost

	From Docket No. R2001-1									HSBC		
	TYBR 2003 Total Unit Cost (Dollars) (1)	TYBR 2003 Mail Proc Unit Cost (Dollars) (2)	TYBR 2003 Delivery Unit Cost (Dollars) (3)	TYBR 2003 Other Unit Cost (Dollars) (4)	TYBR 2003 Total Unit Cost (Dollars) (5)	FY 2005 Total Unit Cost (Dollars) (6)	BY 2000 Mail Volume (Pieces) (7)	FY 2003 Mail Volume (Pieces) (8)	FY 2003 Mail Volume (Percent) (9)	TY 2005 Total Unit Cost (Dollars) (10)	FY 2004 Mail Volume (Pieces) (11)	FY 2004 Mail Volume (Percent) (12)
LETTERS												
Nonauto Basic		0.130	0.042	0.01	0.18	0.19	1,322,401,662	1,411,242,831	3.2%	0.19	1,197,383	0.4%
Nonauto 3/5-Digit		0.121	0.044	0.01	0.17	0.19	4,476,247,838	2,481,782,907	5.7%	0.19	469,903	0.2%
Auto Mixed AADC		0.050	0.039	0.01	0.10	0.10	2,354,963,527	2,687,599,740	6.1%	0.10	7,219,345	2.3%
Auto AADC		0.043	0.038	0.01	0.09	0.09	2,875,476,520	2,848,635,910	6.5%	0.09	20,311,073	6.5%
Auto 3-digit		0.040	0.038	0.01	0.08	0.09	15,600,801,986	17,815,958,778	40.6%	0.09	182,672,355	58.4%
Auto 5-digit		0.031	0.037	0.01	0.07	0.08	11,222,413,732	16,604,952,264	37.9%	0.08	101,052,532	32.3%
Total/average	**0.096**	**0.05**	**0.04**	**0.01**	**0.09**	**0.10**	**37,852,305,265**	**43,850,172,430**	**100.0%**	**0.09**	**312,922,671**	**100.0%**

Company average letter cost	$ 0.089	(13)
Company average letter cost, including Contingency	$ 0.092	(14)

Standard ECR Unit Cost

	TYBR Unit Costs	
Total ECR letter unit cost	0.072	(15)
Total ECR letter delivery unit cost	0.054	(16)

	TY 2005 Delivery Unit Costs (17)	FY 2004 Mail Volume (18)	FY 2004 Mail Volume (19)
ECR Basic Auto Letters	0.050	12,494,212	99.8%
ECR Basic Letters	0.069	20,947	0.2%
	0.051	0	0.0%
ECR Saturation Letters	0.036	0	0.0%
Total		12,515,159	

Company Average letter ECR Unit Delivery Cost	0.050	(20)
Company Delivery Cost Adjustment	-0.004	(21)
Company ECR total letter unit cost	0.068	(22)
Company ECR total letter unit cost, including Contingency	0.070	(23)

Average Cost per piece 0.0910 (24)

(1) Docket No. R2001-1, LR-J-58, LR58AREG.xls, total unit letter costs
(2) Docket R2001-1, LR-J-60 Revised 11/15/01
(3) Docket R2001-1, LR-J-60 Revised 11/15/01
(4) (1) - average from (2) - average from (3)
(5) (2) + (3) + (4)
(6) (5) * (1 + inflation cost adjustment factor) * (1 + inflation cost adjustment factor)
(7) Docket No. R2001, PRC, LR-4, SM base year volumes from SM letter model.
(8) Revenue, Pieces, and Weight (RPW) Report.
(9) Each row in (8) divided by total in (8)
(10) (6)
(11) CBCIS 2004 HSBC Volume Data
(12) Each row in column (11) divided by total in column (11)
(13) Weighted average costs calculated by multiplying column (10) by column (12)
(14) (13) * Contigency Factor (Assumptions)
(15) Docket No. R2001-1, LR-J-58, LR58AECR.xls, total TY2003 ECR unit letter costs * (1 + inflation cost adjustment factor) * (1 + inflation cost adjustment factor)
(16) Docket No. R2001-1, LR-J-58, LR58AECR.xls, sum of TY2003 ECR unit letter delivery costs
(Cost segments 6, 7 and 10) * (1 + inflation cost adjustment factor) * (1 + inflation cost adjustment factor)
(17) Docket No. R2001-1, LR-J-117, Revised 1/22/02, TY2003 unit delivery costs *(1 + inflation cost adjustment factor) * (1 + inflation cost adjustment factor)
(18) CBCIS 2004 HSBC Volume Data
(19) Percent of volume in each row of (18) divided by total in (18)
(20) Weighted average of the unit costs in (17) weighted by the volume percents in (19)
(21) (20) - (16)
(22) (15) + (21)
(23) (22) * Contingency Factor (Assumptions)
(24) ((14 * 11) + (23 * 18)) / (11 + 18)

HSBC North America Holdings Inc. Model

Negotiated Service Agreement
Appendix A, page 11

		Year 1	(14) Year 2	(15) Year 3
First Class Letter				
(1)	Avg Revenue First-Class Operational Letters	0.292	0.292	0.292
(2)	Avg Revenue First-Class Marketing Letters	0.295	0.295	0.295
(3)	First-Class Operational Letter cost per Piece Before Rates	0.112	0.117	0.122
(4)	First-Class Operational Letter cost per Piece After Rates	0.112	0.117	0.122
(5)	First-Class Operational Letter avg. Contribution Before Rates	0.180	0.175	0.171
(6)	First-Class Operational Letter avg. Contribution After Rates	0.180	0.175	0.171
(7)	First-Class Marketing Letter cost per Piece Before Rates	0.138	0.144	0.150
(8)	First-Class Marketing Letter cost per Piece After Rates	0.129	0.134	0.140
(9)	First-Class Marketing Letter avg. Contribution Before Rates	0.157	0.151	0.146
(10)	First-Class Marketing Letter avg. Contribution After Rates	0.166	0.161	0.155
Standard Mail				
(11)	Standard Revenue per Piece	0.182	0.182	0.182
(12)	Standard Cost per Piece	0.091	0.095	0.098
(13)	Standard Mail Contribution per Piece	0.091	0.088	0.084

(1) Revenue per piece (Ops unit rev)
(2) Revenue per piece (Mktg unit rev)
(3) Current Total Unit Cost Estimates, Including Contingency (Stmt unit cost)
(4) After Rates Total Unit Cost Estimates, Including Contingency (Stmt unit cost)
(5) (1) - (3)
(6) (1) - (4)
(7) CurrentTotal Unit Cost Estimates, Including Contingency (Mktg unit cost)
(8) After Rates Total Unit Cost Estimates, Including Contingency (Mktg unit cost)
(9) (2) - (7)
(10) (2) - (8)
(11) Average Revenue per Piece (SM rev calcs)
(12) Average Cost per Piece (SM cost calcs)
(13) (11) - (12)
(14) Year 1 * Inflation cost adjustment factor Year 2 (Assumptions)
(15) Year 2 * Inflation cost adjustment factor Year 3 (Assumptions)

HSBC North America Holdings Inc. Model

Negotiated Service Agreement
Appendix A, page 12

		Year 1	Year 2	Year 3	Total
ACS Savings					
(1)	Statement Mail	$ -	$ -	$ -	-
(2)	Marketing Mail Letter	$ 1,423,448	$ 2,293,954	$ 2,911,882	**6,629,284**
Contribution from New Volume					
(3)	Statement Mail	$ -	$ -	$ -	-
(4)	Marketing Mail Letter	$ 1,190,845	$ 1,457,936	$ 1,426,090	**4,074,871**
(5) Total Exposure		$ 656,340	$ 964,968	$ 1,172,146	**2,793,454**
(6) Total Incremental Discounts		$ 411,268	$ 592,994	$ 628,691	**1,632,953**
(7) Total USPS Value		$ 1,546,685	$ 2,193,928	$ 2,537,135	6,277,748

(1) Statement Mail Return Costs - Statement Mail After Rates Return Costs (UAA calcs)
(2) Marketing Mail Return Costs - Marketing Mail After Rates Return Costs (UAA calcs)
(3) (Statement Mail After Rates - Statement Mail Before Rates) * FCM Statement Letter avg. Contribution After Rates
(4) Conversion Rate * (Marketing Mail After Rates - Marketing Mail Before Rates) *
(FCM Marketing Letter avg. Contribution After Rates - Standard Mail Contribution per Piece) +
(1 - Conversion Rate) * (Marketing Mail After Rates - Marketing Mail Before Rates) * FCM Marketing Letter avg. Contribution After Rates
(5) Total Leakage (Disc&Leak)
(6) Discount Earned - Total Leakage (Disc&Leak)
(7) (1) + (2) + (3) + (4) - (5) - (6)

Appendix B

EXPLANATION OF FINANCIAL MODEL

The HSBC Model incorporates all of the cost and revenue per piece information into one comprehensive workbook. It serves as a presentation mechanism for the customer-specific revenue and cost calculations. The model was built upon the same revenue and cost assumptions (discount, and exposure (leakage) calculations) as the Capital One NSA. The historical and forecasted volumes are provided by HSBC witness Harvey (HSBC-T-1). These inputs provide the basis for calculating the value of the NSA.

Assumptions

The assumptions contain the return rate for HSBC' mail mix as provided by witness Harvey (HSBC-T-1). The inflation cost adjustment factor, a weighted average of inflationary factors, represents the inflationary cost growth projected by the Postal Service. Currently, that factor is 4 percent. The Capital One manual and electronic return unit costs for letters serve as proxies in the HSBC Model (USPS-LR-1/MC2002-2). Costs for Years 1, 2, and 3 of the agreement are adjusted by the inflationary cost growth of 4 percent. The Address Change Service (ACS) success rate was explained by USPS witness Wilson (MC2002-2, USPS-T-4 at 7, Line 4) and is assumed to be constant throughout the life of the agreement. The HSBC model assumes 100 percent of the incremental mail volume growth will come from migrating Standard Mail to First-Class Mail for all marketing letters. The contingency is a multiplicative factor applied

uniformly to all forecasted postal costs, including First-Class Mail, Standard Mail, and the physical and electronic costs of ACS.[1]

Volume Calculations

The Volume Calculations contain HSBC' mailing mix, consisting of operational mail and marketing mail letters. The mailing mix for 2002 – 2004 provides a historical view of HSBC' past mailing profile. To illustrate the volume response to incentives, HSBC witness Harvey (HSBC-T-1) has provided the volume forecasts for HSBC, both in the absence of an agreement (BR) and in the presence of an agreement (AR).

First-Class Mail Revenue Calculations

The Rate Category of the model shows the First-Class Mail profile of HSBC. It is similar to the profile in the Capital One NSA (MC2002-2, USPS-T-3). It provides a representation of the estimated revenue per piece for HSBC marketing and operational mail pieces.

Operational Unit Cost and Marketing Unit Cost

The cost estimates for Operational Unit Cost were built on the same assumptions of the First-Class Mail Presort Letters/Flats Unit Cost Estimate of witness Crum (MC2002-2, USPS-T-3 Atta2.xls) for the Capital One NSA. Estimates for the HSBC NSA differ from those of the Capital One NSA in the Test Year (TY) calculations, the HSBC volumes, and the total unit cost (columns 17 and 18). The TYBR 2003 unit cost

[1] The contingency is applied to all forecasted postal costs to protect against unforeseen circumstances. It is applied as the very last step in development of the roll-forward costs. *It needs to be incorporated in NSA calculations for two reasons.* First, the existing rates from which the NSA rates or discounts are being derived include contingency. In the absence of an NSA, the rates that HSBC would be paying would have been set so as to recover the contingency. Furthermore, the NSA financial analyses are projections into the future, and the further into the future the projections are made, the more appropriate the application of the contingency.

is based on Docket No. R2001-1, with the weighted distributions calculated from Base Year (BY) 2000 FCM base year volumes from the FCM letter model from Docket No. R2001, PRC, LR-4. The TY 2005 cost estimates were derived by multiplying the TYBR 2003 Total Unit Cost by the inflationary growth rate of 8.0 percent (4.0 percent x 2 years).[2] FY 2004 Mail Volume for HSBC was used because it was the latest full year historical volume available. The Total Unit Cost Estimates, including Contingency (Attachment A, page 4, sources 17 and 18) are equal, based on the assumption that the before and after rates forecasts of operational mail remain the same.

The Marketing Unit Cost is built on the same assumptions as the Operational Unit Cost. The major difference is electronic diversion from ACS and the cost differential between manual and electronic returns for UAA mail. Operational mail does not receive the Change Service Requested (CSR) endorsement because it needs to be physically returned to HSBC. Marketing mail receives the endorsement, and information is returned from UAA mail electronically 85 per cent of the time. This explains why the Total Unit Cost, including Contingency, differ in sources 17 and 18 (Pg. 6); the after-rates unit cost is 1.0 cents less than the before-rates unit cost.

Discount and Exposure

The declining block rate structure for the proposed NSA for Year 1 begins at 615,000,000 pieces, with a discount of 2.5 cents per piece; for Year 2 begins at

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[2] Columns are labeled as "TYBR 2003" in these sheets because those figures are drawn from Docket No. R2001-1, in which FY 2003 was the test year. Columns are labeled as "TY 2005" because FY 2005 s the first of the three years in which the instant NSA is assumed to be in effect. Estimates for the last two years of the agreement, Years 2 and 3, are presented in the subsequent sheets. FY 2005 is not the exclusive "test year" in this proceeding in the sense that FY 2003 was the test year in the Capital One proceeding. It is, rather, one of three relevant years for which estimates are presented and evaluated.

725,000,000 with a discount of 2.5 cents per piece; and for Year 3 begins at 810,000,000 with a discount of 2.5 cents per piece. Exposure (to the Postal Service) measures the discounted revenue associated with declining block rates for mail volume that HSBC would have mailed in the absence of the proposed NSA. HSBC's BR Forecast for Year 1 falls within the first tier of the discount structure. Total exposure is therefore calculated for Year 1 by subtracting the BR Forecast from the beginning threshold (641,253,619 – 615,000,000 = 26,253,619), and the difference is multiplied by the corresponding incentive (2.5 cents). The first tier exposure and total exposure equals $656,340 (26,253,619 x .025). This same formula is applied to the Year 2 and 3 of the agreement, with the total exposure equaling $964,968 and $1,172,146 respectively.

Based on the Y1AR Forecast, HSBC could achieve discounts in the first year of the agreement, equaling $1,067,609, using the same formula as exposure. Discounts are given on pieces mailed above the threshold. Double counting of the 26,253,619 (Y1BR – Beginning Threshold: 641,253,619 – 615,000,000) mail pieces occurs in the discount and exposure calculations, because the 26,253,619 pieces are the exposure calculation. The Y1AR of 656,253,619 is made up of the Y1BR plus the 16,000,000 additional marketing pieces. To account for this double counting, the Postal Service subtracts the exposure from the discount, to get the incremental discount calculation of $411,268 (Attachment A, page 12). This same formula is applied to the Year 2 and 3 of the agreement, with the total incremental discounts equaling $592,994 and $628,691 respectively.

UAA Calculations

In lieu of receiving physical returns, HSBC will accept electronic information for address changes or corrections, as Capital One does. This results in cost savings to the Postal Service by replacing costly physical returns with the less costly transmission of electronic information. The estimated Capital One physical and electronic return unit costs described in USPS-LR-1/MC2002-2 will be used in the HSBC model. The total return costs savings vary from the Capital One model because of the different marketing mail volumes, and return rate forecasts (4.75 percent for marketing mail letters).

To calculate the cost savings, the expected volume of HSBC's UAA mail times unit costs savings for each piece processed through the ACS is multiplied by the percentage of HSBC's UAA mail that will be processed. The calculation relies upon the evidence in MC2002-2 for 1) the percentage of UAA mail that will be processed through the ACS system (85%) and 2) the unit savings for each UAA piece processed through the ACS system.

Standard Mail Revenue Calculations and Standard Mail Cost Calculations

The Standard Mail Regular and Enhanced Carrier Route (ECR) Revenues are based on the Standard Mail Regular and ECR Billing Determinants of HSBC. The revenue per piece for both Regular and ECR is a weighted average of the revenue per piece and HSBC volume. The Standard Regular and ECR unit costs are based on Docket No. R2001-1 for TY 2003 unit costs. The format for 2005 unit costs follows the First-Class Mail unit cost estimates on pages 4 and 5. This provides the customer-specific revenue and cost data on HSBC' Standard Mail.

Contribution Inputs

The Contribution Inputs calculate the contribution per piece of HSBC's operational mail and marketing mail letters. This per piece calculation provides the Postal Service with before and after rates revenue, cost, and contribution for First-Class Mail and Standard Mail on a customer-specific basis. It also allows for forecasting future contribution per piece in the out-years of the agreement by allowing the inflationary growth to be multiplied by the cost of each subclass. Unit revenue remains constant over the three-year agreement.

USPS Value

The total USPS value is derived from the value determinants, less the discount and exposure associated with the declining block rate structure. "Contribution from New Volume" is any volume above the before rates forecast multiplied by the difference between the First-Class Mail and Standard Mail estimated contributions. This is so because HSBC indicates that all of its new First-Class Mail volume will be switched from Standard Mail (100% conversion).

Appendix C

HSBC FINANCIAL SERVICES NSA
PROPOSED DATA COLLECTION PLAN

The Postal Service plans to collect the following data pertaining to the NSA with HSBC Financial Services, Inc. (HSBC):

1. The volume of First-Class Mail solicitations by rate category in eligible HSBC permit accounts;

2. The volume of First-Class Mail customer mail by rate category in eligible HSBC permit accounts;

3. The amount of discounts paid to HSBC for First-Class Mail by incremental volume block;

4. The volume of First-Class Mail solicitations bearing the ACS endorsement that are physically returned to HSBC;

5. The number of electronic address correction notices provided to HSBC for forwarded solicitation mailpieces, including the number of notices processed by CFS units and separately for PARS (when fully operational).

6. The number of electronic address correction notices provided to HSBC for solicitation mailpieces that would otherwise be physically returned, including the number of notices processed by CFS units and separately for PARS (when fully operational).

7. Monthly estimate of the amount of time spent on compliance activity and a description of the activities performed.

8. For each First-Class Mail solicitation mailing list run against NCOA, HSBC will provide NCOA contractor reports that separately identify the number of address records checked and the number of corrections made.

9. For each Change of Address record that is used to forward a piece of HSBC solicitation mail through ACS under the Agreement, the Postal Service will provide the date the record was created, its move effective date, whether it was for a family or individual move, and each date that the record was used to forward a mail piece. No other information from the record would be provided.

As part of each data collection plan report, the Postal Service will provide an evaluation of the impact on contribution. It will also provide an assessment of trends of HSBC' First-Class Mail volume as compared to overall First-Class Mail volume.

Revised: March 11, 2005

1 Data collected under the plan shall be reported annually following the end of the fiscal year, with the first report being made available at the end of FY2005. The Postal Service shall provide the data in a PC-available format.

POSTAL RATE COMMISSION
DOCKET NO. MC2005-2
DECLARATION OF JESSICA A. DAUER

I hereby declare, under penalty of perjury, that:

The direct testimony of Jessica A. Dauer on Behalf of the United States Postal Service, USPS-T-1, as amended by errata on March 11, March 22, and April 14, 2005, was prepared by me or under my direction; and

If I were to give this testimony before the Commission orally today, it would be the same.

I prepared the interrogatory responses, and responses to Presiding Officer's Information Requests Nos. 1 and 2, which were filed under my name and which have been designated for inclusion in the record in this docket, and

If I were to respond to these interrogatories and Presiding Officer's Information Requests orally today, the responses would be the same.

Jessica A Dauer
Jessica A. Dauer

DATE 4/18/05

RESPONSE OF THE UNITED STATES POSTAL SERVICE TO INTERROGATORIES OF THE OCA

OCA/USPS-1. Please confirm that Jim Wilson, who testified on behalf of the Postal Service in Docket No. MC2002-2, spoke at the National Postal Forum, held in Nashville, TN, in March 2005. If the Postal Service does not confirm, then please provide an explanation.

a. Confirm that topics addressed in his presentation included the National Change of Address (NCOA) service, Address Change Service (ACS), and NCOALink. If the Postal Service does not confirm, then please explain.

b. Confirm that, at the Forum, the Postal Service presented the results of data from an "average" 20-million-piece First-Class mailing where the NCOA service was utilized prior to the mailing and ACS was used when the pieces were mailed. If the Postal Service does not confirm, then please explain.

c. Confirm that the 20 million-piece-mailing revealed that when an address was ZIP+4 coded, 91.7% of the mail was delivered, 5.94% of the mail was returned, and 2.35% of the mail was forwarded. If the Postal Service does not confirm, then please explain.

RESPONSE:

Confirmed.

a) Confirmed.

b) Not confirmed. The reference to an "average" was not presented by Mr. Wilson in association with the data relating to the 20 million piece First-Class mailing.

c) Confirmed for the mailing for which data were presented, but exclusively with respect to the pieces that were ZIP+4 coded. Please note that there was an assumption that what was not returned and not forwarded was delivered.